American Telephone and Telegraph Company 1981 Annual Report

The 97th Annual Meeting of AT&T shareholders will be held at 2:00 p.m. on Wednesday, April 21, 1982, at the Baltimore Convention Center, Baltimore, MD.

The consolidated financial results in this report are for American Telephone and Telegraph Company and its subsidiaries.

If you wish further information, the following are available upon request:

- 1981 Statistical Report, with additional data on our operations.

- Form 10-K, AT&T's annual report to the Securities and Exchange Commission.

- Annual reports of the Bell telephone operating companies, the Western Electric Company and Bell Laboratories.

- Information relating to various Bell System benefit plans.

- Information on charitable contributions.

The AT&T Annual Report will be available in braille, talking records and cassettes.

Address requests to the Secretary, AT&T Co., Room 2615, 195 Broadway, New York, NY 10007. The telephone number of the Company is 212-393-9800.

Information on AT&T common and preferred stock, bonds, dividends or interest payments and the Dividend Reinvestment and Stock Purchase Plan can be obtained by calling without charge 800-631-3311 or, from New Jersey, 800-352-4900. Mailed inquiries should be addressed to AT&T Co., P.O. Box 2018, New Brunswick, NJ 08903. The Company maintains stock transfer offices at 250 Broadway, 15th floor, New York, NY 10007 and at 444 Hoes Lane, Piscataway, NJ 08854.

Highlights	1981	1980
Earnings per share	$ 8.55	$ 8.17
Dividends declared per common share	$ 5.40	$ 5.00
Revenues, including other income (millions)	$59,229	$51,755
Expenses, including taxes and interest (millions)	$52,341	$45,697
Net income (millions)	$ 6,888	$ 6,058
Rate of return on average total capital	10.3%	9.9%

American Telephone and Telegraph Company 1981 Annual Report

Cover: The Bell seal, its design altered from time to time over the years, was adopted by AT&T in 1889. To generations of Americans and telephone employees, it has come to represent quality service and corporate responsibility.

The Bell System

AT&T, as parent organization, establishes policy and provides detailed day-to-day guidance in the development of technology and customer services for the rest of the Bell System.

Twenty local operating companies are wholly owned by AT&T, and the company has been seeking to acquire through merger the outstanding shares of The Pacific Telephone and Telegraph Company, in which it has a majority ownership. The Bell Telephone Company of Nevada is wholly owned by Pacific Telephone. AT&T has a noncontrolling ownership in two companies: Cincinnati Bell Inc. (30.6%) and The Southern New England Telephone Company (22.4%).

AT&T's Long Lines Department operates the interstate long distance network that interconnects Bell and Independent telephone companies and provides connecting links between the U.S. and telecommunications systems overseas.

Western Electric, a wholly owned subsidiary, manufactures and purchases telecommunications products and supplies for the Bell System.

Bell Laboratories, jointly owned by AT&T and Western Electric, provides research and development services.

AT&T International, Inc., a wholly owned subsidiary of AT&T, markets Bell System products and services outside the U.S.

Report of the Chairman of the Board

As 1981 drew to a close, it became evident that we were facing what surely was one of the most crucial decisions ever to confront the management of AT&T.

The government antitrust trial was approaching its conclusion and, however the case was decided, the prospect was for years of appeals and continued uncertainty. At the same time, legislation pending in both Houses of Congress and new regulatory ground rules established by the Federal Communications Commission made it certain that, to one extent or another, the existing structure of the Bell System would have to be altered. Indeed, the telecommunications marketplace itself, radically different from what it was only a decade ago, made structural changes inevitable if we were to retain our service capabilities and adequately position ourselves to take advantage of new market opportunities.

Also, no matter what happened in court, in Congress or at the FCC, the 1956 Consent Decree–its constraints outdated by advances in technology–would remain hovering like a dark cloud over our future.

Clearly, it was time to act, time to put uncertainties behind us and to begin reshaping the Bell System's structure and operations to match the requirements of a new era.

So the historic decision was made. We agreed to the government's proposal requiring divestiture by AT&T of the local service operations of the Bell operating companies. The 1956 Consent Decree was modified and its restrictions, confining AT&T to regulated businesses only, were eliminated.

To be retained by AT&T are all Bell System interstate facilities and a portion of the intrastate long distance facilities now owned by the local Bell companies; Western Electric; Bell Laboratories; and customer premises equipment, including telephones.

This is not the solution we sought. Why, then, did we agree to the Decree–this rearrangement of an organizational structure that has served this country so well for so long? Because, when all was said and done, it was obvious that in accepting the agreement we were only acknowledging what already had been decided: not in court, but as a consequence of the vigorous testing over time of contending ideas and proposals within the industry, in government and, most significantly, in the marketplace.

As AT&T share owners, you will continue to retain the full value of the assets currently represented in your investment. But rather than holding shares only in AT&T, share owners also will be assigned proportionate values for the divested parts of the company. Approximately two-thirds of the Bell System's total assets currently are associated with the local exchange aspects of the business which would be divested.

When will this happen? The Consent Decree provides for the divestiture to take place 18 months after the Decree's court approval. Six months after the approval date we are committed to giving the Justice Department a plan explaining how it will be done.

Some questions, including the form of organization to be adopted for the divested companies, are still without answers at this point. We will make every effort to keep you informed. In the meantime, as I said in my January 12 message to share owners, I hope that we can count on your continued support.

The Consent Decree is an attempt to balance, in addition to the interests of our three million share owners, the interests of the tens of millions of people who use our services, of more than a million Bell System employees and of the nation as a whole. We believe we were successful in achieving a reasonable balance in all respects.

A major consideration on our part and the government's was to assure to the extent we can that this country's telecommunications industry will retain its leadership position in world markets. Another was to arrive at an operating framework that will help to promote the full development of Information Age technologies and bring their benefits to the American public.

In short, we believe the Consent Decree meets every relevant test of the public interest. We look forward to its acceptance by the court. We trust that–having indicated AT&T's

willingness to make the very significant changes required by the Decree –the Congress and the FCC will carefully consider these prospective changes in their further efforts to provide the industry and the public with a new national telecommunications policy and the ground rules to make that policy work.

Additional details about the Consent Decree can be found elsewhere in this report. But critical as this development is to our future, it should not overshadow the very significant accomplishments of the Bell System in 1981.

Earnings Improved

In the year's unsettled economic circumstances, we improved earnings. We also improved service–not only in terms of the quality of service we provided but in the technological and marketing response we demonstrated in meeting customer needs. We increased the quarterly dividend from $1.25 to $1.35. The price performance of our stock improved, and we were able to finance our capital requirements in debt and equity markets that most other businesses found trying at best.

For the sixth consecutive year, earnings per share and net income were higher than the year before.

Earnings per share were $8.55, an increase of 38 cents over the previous year. Net income increased 13.7 percent to $6.9 billion. Return to common equity was 12.9 percent, compared to 12.7 percent the year before.

Operating revenues amounted to $58.2 billion, increasing 14.5 percent. Operating expenses rose 14.7 percent to $39.3 billion.

Reflecting in part an economy that started the year strong but closed in recession, the demand for our services continued to grow but in some respects at a pace short of our expectations.

Our overall volume of business was up 8.6 percent over 1980. WATS messages, which currently account for about one of every five long distance calls, increased 16 percent. Message Telephone Service increased 6.6 percent, a rate slower than the previous year. We achieved a net gain of 2.1 million access lines, compared to 2.5 million in 1980.

To make our earnings, we sought at every turn to match Bell System capabilities and resources to needs in the marketplace. We expanded our marketing and sales efforts. In providing service and in operating the business, we improved our productivity.

Where adjustments in rates were needed, we urged our regulators–with considerable success, to their credit–to take into account not only the effects of inflation and high capital costs but also competition's impact on traditional telephone pricing structures and depreciation practices.

The Federal Communications Commission authorized a rate of return of 12.5 to 13 percent on our interstate and nondomestic operations, earnings which would represent a return of 17.4 percent on share owners' common equity. Higher rates put into effect in 1981 for interstate long distance messages, WATS and private line services will increase revenues by some $1 billion annually. Additional annual revenue from intrastate rate increases granted during the year will amount to approximately $3.2 billion.

We are challenged year after year to make and finance only those capital investments that are essential to our future, no more and no less. For the first time in five years, we were able to hold down the increase in Bell System capital expenditures to less than $1 billion. We invested $18.1 billion, about $800 million more than in 1980.

To help finance our capital needs for the year, we raised $6.6 billion in outside capital, slightly less than the previous year.

Approximately $3.5 billion was acquired through debt offerings by AT&T and the Bell System subsidiaries. As a result of the high interest rates prevailing for long-term corporate bonds, the composite cost to the company for 20 debt offerings in 1981 was 15.5 percent, up from 1980's 12.5 percent.

We raised nearly $3.2 billion in equity, including $1 billion from the sale of 18 million common shares in June–our first common stock offering in almost four years and the largest in Wall Street history.

New Economic Realities

In a highly regulated industry, as ours has been over the years, plant investment can be recovered over long periods of time. This way, depreciation expenses and, consequently, revenue requirements are lessened.

But in a time of rapid changes in technology and in a marketplace that grows more competitive year by year, creating greater risk for investors, we confront a new set of economic realities. Assuring the continued financial integrity of our share owners' investment in this new environment requires us to enhance our internal cash flow and reduce our dependence on external capital markets.

So, with FCC approval, we are instituting changes in the way we calculate the depreciation of plant investment. The changes will have the effect of increasing depreciation rates so as to accelerate the recovery of our capital investment.

In addition, the FCC has ruled that costs associated with installing new inside wiring and terminal equipment should be considered a current expense rather than a capital investment. These costs can be recovered through higher installation charges from the people incurring the costs rather than being carried as a capital investment to be borne by future ratepayers.

Finally, the Bell System, like other businesses, will benefit from the accelerated cost recovery provisions of the Economic Recovery Tax Act of 1981. The faster tax depreciation of new plant allowed for in the law will increase the internally generated funds available to us for capital investment.

Looking ahead, we are encouraged by the success achieved in slowing the tides of inflation and we anticipate the resumption of a stronger economy. We are encouraged as well by the leadership shown by the Administration and the Congress in taking new and promising directions in economic policies and in promoting a renewed emphasis on individual enterprise.

Confidence in Ourselves

On a personal note, I grew up in the Bell System "family"–in the organizational sense of that word–as well as in a Bell System family in the personal sense. My mother, father and sister all served in the System. I have served in it for 35 years. Thus, it was a wrenchingly difficult decision to agree to the divestiture now contemplated.

But I am convinced that we have chosen the right course and, as proud as we are of our past, we do not intend to become prisoners of it.

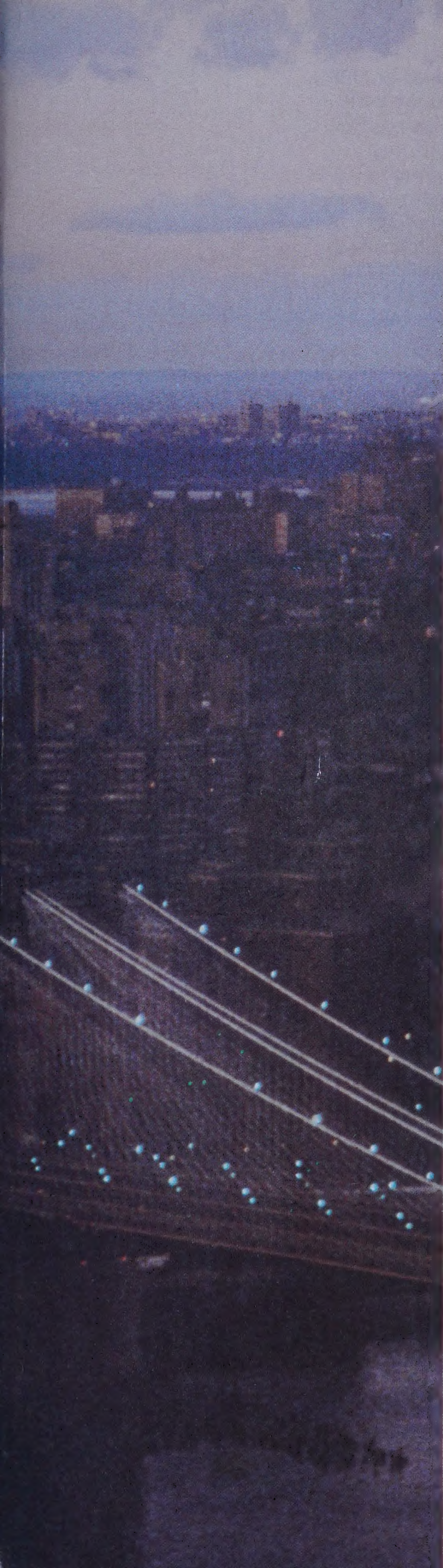
The success achieved by the Bell System in a history that goes back more than a hundred years can be traced to spirit and motivation as much or more than to anything else. That spirit, that motivation will be unchanged in the new structure because it derives not from organizational arrangements but from the minds and hearts of people.

So our confidence in the future is based most of all on the men and women who made 1981 a successful year. Some of them appear on the pages of this report. They are in marketing and sales; they are engineers and technicians; they are in research, development and production. Some are managers, some not. Some come into regular contact with customers, some don't.

Together they represent the people and jobs that make up the national and local entities of our company. But, as their own words suggest, they represent a spirit as well. They are unafraid to accept new challenges, eager to take advantage of new opportunities. Simply put, they are ready for the future.

C. L. Brown

February 8, 1982



New York Telephone Company building, lower Manhattan

A New Era

For most of the Bell System's history, our business was easily defined. It was, simply, the telephone business.

Then, in recent decades, as telephone lines began carrying television, data and other forms of communications as well as telephone calls, it was evident that the business was changing. It had become telecommunications.

Now our business is changing once again. It is communications enhanced by information technologies. It is the business of transporting and managing information.

In short, it is a new era.

Three influences have quickened the pace of change in the industry: the development of new, Information Age markets for communications and information-related services; advances in technology that helped create these new markets and which will foster their growth; and the unfolding of governmental policies endorsing increased competition and reduced regulation.

Responding effectively to the changes taking place in the industry requires changes on our part, too: changes in the way we provide and price our services, in the financial management of the business and, most of all, in the way we are structured.

The Consent Decree agreed to by AT&T early in 1982, the basis for the government's action in agreeing to drop its antitrust suit, is a clear demonstration of our readiness to adapt to the changed environment we confront in the 1980's.

Restructuring the Bell System

As noted earlier, the Decree requires AT&T to divest the local service facilities of the Bell operating companies, representing more than $80 billion in assets. These are the facilities used to make local calls and to gain access to the long distance and international networks.

The Bell System's interexchange facilities and the customer premises equipment business, as well as manufacturing operations and research and development, would be retained by AT&T. Organizationally, this includes the Long Lines Department, which manages the nationwide telecommunications network and handles international communications, Western Electric and Bell Laboratories.

Both AT&T and the companies that will be divested are financially healthy enterprises. It is our firm objective to assure that they continue to be profitable businesses.

Local service will continue to be regulated by the state commissions, interstate service by the FCC. On the other hand, some or all of AT&T's services, aside from the public long distance business, presumably would be provided free of traditional regulatory constraints.

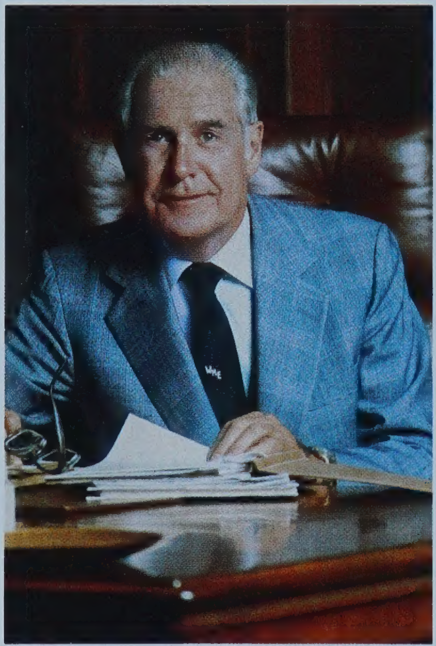
The agreement reflects the public's interest in maintaining quality local service and, at the same time, in preserving a nationwide network that ties the country's telephones and other terminals into one dependable, efficient telecommunications system. It also offers the assurance that coordination necessary for national security purposes is maintained.

The Decree, which specifies that there was no finding or admission that the Bell System had violated the antitrust laws, was filed on January 8, 1982. On January 21, U.S. District Court Judge Harold H. Greene in Washington, D.C. set forth procedures to give all interested parties an opportunity to comment on it. We are confident that, after this period of public comment and judicial review, the agreement will be found to be in the public interest.

Within six months of its effective date, the Decree requires AT&T to file with the Justice Department a plan for reorganizing the divested telephone companies. The form that reorganization would take still has to be worked out. The divestiture would take place one year later.

However, for a five-year transition period AT&T, Western Electric and Bell Laboratories would provide on a priority basis the manufacturing, research

"We are restructuring our organization not to limit our opportunities but to take advantage of new opportunities– in regulated as well as deregulated parts of the business."



William M. Ellinghaus
President, AT&T

"We have the technological know-how to introduce new products and systems in a timely fashion; we have made giant strides in understanding the marketplace; and we are making good progress in professionalizing our sales force."

James E. Olson
Vice Chairman, AT&T

and development services needed by the divested companies to implement the Decree.

As for active and retired Bell System employees, the Decree does not affect wages, benefits or pensions. Nor does it affect existing bargaining agreements.

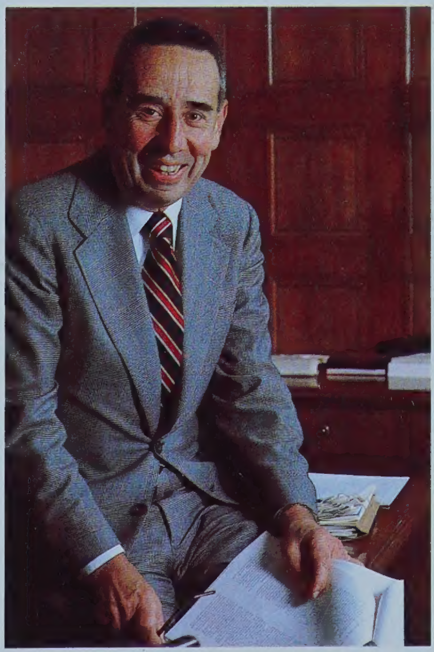
The antitrust suit was filed by the government in November, 1974. It went to trial in January, 1981 and was scheduled to conclude early in 1982, with a court decision expected by midsummer. However the trial would have been decided, appeals prolonging the case for several years were likely.

A Head Start

Anticipating that parts of the business would be subject to less regulation than has been customary in our industry, we already had set in motion a restructuring plan designed to satisfy our own business needs and to meet new regulatory and legislative requirements.

In particular, the restructuring we had begun was in line with the basic thrust of the FCC's decision in what is known as the Second Computer Inquiry.

"In the same spirit that we are looking in new ways at our business' structure, we also are taking new approaches to its financial management –approaches that are appropriate to the changed regulatory and economic conditions we confront."



William S. Cashel, Jr.
Vice Chairman and Chief Financial Officer, AT&T

In essence, we planned to divide our activities into two parts, both accountable to AT&T management. The first part was to represent the core of our traditional telephone operations, the second and smaller part encompassing detariffed or deregulated operations.

The principal component of the latter part of the business was to be a separate subsidiary to provide enhanced services and customer premises equipment. We filed a capitalization plan with the FCC in November to establish this subsidiary, and we intend to go ahead with this plan. The subsidiary's first offering will be Advanced Communications Service, an enhanced, shared, data communications network service.

We started reassigning people and functions within AT&T headquarters in 1981, while the Bell System units began the planning necessary to separate their operations between regulated common carrier services and those services that would be provided in a detariffed or deregulated environment. Toward that end we consolidated the Bell operating companies' marketing, service and field support organizations into six geographical regions, each to have its own sales and service organization.

Restructuring a business as large as the Bell System is immensely complicated. The separation of assets and people and the disaggregation of administrative and operating systems require enormously detailed planning.

Much of the planning for restructuring that was carried out during the year will give us a head start in the reorganization work required by the Consent Decree.

In addition, an executive realignment announced soon after the Decree was filed will facilitate making the changes required by the Decree while, at the same time, assuring that current business needs are met. In the future, Chairman of the Board C. L. Brown, President William Ellinghaus and Vice Chairmen William Cashel, Jr. and James Olson will concern themselves primarily with overall corporate strategy, resource allocation and critical issues. The day-to-day running of AT&T will be shared by five executive vice presidents.


electron on a film of liquid
He
Integral technique to
mass

"Fundamental research is vital because it undergirds the forward looking technology that we need in the 1980's. AT&T's financial commitment is critically important to sustaining the research work done at Bell Laboratories–and will continue to be in the future."

Dr. Shirley A. Jackson
Member of Technical Staff, Bell Laboratories

"We must continue to seek new knowledge, to exercise our ingenuity, to encourage curiosity. Scientists must recognize and consider the wants and needs of society. Society must choose its technological options wisely."

Dr. Arno A. Penzias
Vice President, Research, Bell Laboratories (Co-winner 1978 Nobel Prize in Physics)

In the Forefront of Technology

The Information Age is the child of technology, in large part technology invented and developed by Bell Laboratories, applied by Western Electric and channeled to the marketplace by AT&T and the Bell operating companies.

It was at Bell Laboratories, with the invention of the transistor nearly 35 years ago, that the revolution in solid-state technology was born. The Bell System's technological leadership, however, is rooted not in past accomplishments but in present achievements in basic Information Age technologies: in microelectronics, software development, digital systems and lightwave communications.

Microelectronics, for example, has been applied to just about every aspect of our operations and is essential to the intermingling of communications and data processing technologies. Each year since the advent of the integrated circuit, the number of components–such as transistors, capacitors and resistors–that can be placed on a single chip of silicon has doubled. As a result, these tiny devices increasingly are able to perform more functions at less cost.

A digital computer memory developed at Bell Laboratories in 1981 uses a quarter of a million transistors on a single chip, while a newer version of the Bellmac* microprocessor–a computer on a chip–contains 150,000 components. Production of such enormously complex devices requires significant expertise in the development of software to aid their design.

*Trademark of Western Electric Company.

Fundamental to the Bell System's leadership in world telecommunications has been our readiness over the years, even in difficult earnings years, to provide consistent financial support for research and development. Our R&D expenditures in 1981 amounted to $1.7 billion.

No less fundamental to that leadership is the technological integration that stems largely from the close, day-to-day working relationship between Bell Laboratories and Western Electric, the Bell System's manufacturing unit. Retaining this relationship was an important element in considerations leading to the 1982 Consent Decree.

Western Electric was acquired by AT&T a century ago because it was felt then–as it is now–that the process of technological innovation is best served by an organizational structure that integrates manufacturing with research and development. More than just a manufacturer of communications equipment, Western Electric has been a principal component in the building of a telecommunications system that today stands as a model for other nations.

As the year drew to a close, a new $52 million Western Electric software production center was nearing completion in Lisle, Ill. Western Electric's Atlanta Works has gone into full-scale production of lightwave cable, while the Richmond Works is stepping up its production of printed wiring boards, used by the millions in today's world of telecommunications.

Under the terms of the new Consent Decree, restrictions in the 1956 Decree on what Western Electric can manufacture and to whom it can sell its products and equipment would be removed.

The Network

The nationwide telecommunications network is the product of decades of continuous innovation. It daily handles 74 million long distance calls and 10 times that many local calls.

Managed by AT&T's Long Lines Department in cooperation with the local Bell operating companies and some 1,450 Independent telephone companies, the network is in effect the world's largest system of interconnecting computers, there for all to use. The computers in this instance are the electronic switching systems the industry has been installing in the network for the past 15 years.

Electronic switching is the foundation of the network's electronic "intelligence." Equipped with computer memories, these systems can be reprogrammed as needed to meet changing service requirements.

Currently being overlaid on the network and adding to its "intelligence" is an advanced signaling system–in effect, a high-speed data network of its own. The system, Common Channel Interoffice Signaling, already connects electronic switching centers that serve most major metropolitan areas, and we are now beginning to extend it to local central offices.

Besides increasing the efficiency of the network and allowing calls to be set up much more rapidly, this signaling system can carry detailed information about the call itself. This information, interacting with centralized data bases, or Network Control Points, opens the door to a wide range of entirely new network services and improvements in existing services.

As an illustration, credit card calling without operator assistance –Calling Card Service–was introduced in 1981 in St. Louis and will become available throughout the country by mid-1983. Using a Touch-Tone™ telephone, the customer "dials" the credit card number instead of giving it to an operator. A key to this improved service is that the credit card number can be verified through a Network Control Point.

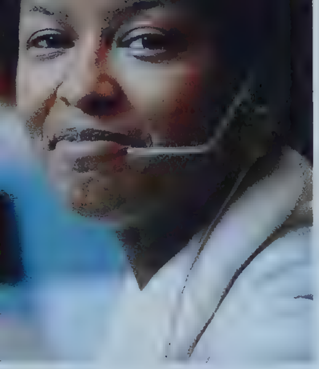
In the future customers might want to signal the network that they will take calls only from certain telephone numbers. Or, with just one number, a person could be reached as he or she traveled around the country. Businesses might have a single nationwide number that, when called, would be channeled to the branch office nearest the caller.

Thus, by adding to the network the latest advances in telecommunications and computer technologies, we can both increase and personalize the network's capabilities.

Moreover, the same technologies we are using to transform the capabilities of the network are being

"The lightwave cable we're putting in on the East Coast represents the most advanced form of transmission in the network. To be competitive we have to be on top of technology."

William J. Leonard
Splicer Foreman,
AT&T Long Lines



"Before, operators used cord boards and it was a manual type of situation. Now it's much faster and we are handling a lot more calls. I'm flexible; I can adjust."

Devonne Tucker
Operator, Ohio Bell

applied as well to functions associated with operating the network. Some 140 computer-based operations-support systems are widely deployed throughout the system, mechanizing and centralizing tasks previously performed manually.

Toward a Digital Network

In the early 1960's we installed the first commercial digital transmission system and introduced Dataphone® service for customers wanting to send data over regular telephone lines. Then in 1974, came Dataphone digital service, currently available in most major U.S. cities and still growing.

Now, in the 1980's, with an increasing demand for data communications services at ever higher speeds, the evolution to a public, nationwide end-to-end digital network is accelerating. This digital network of the future (digital referring to the sending and switching of signals in the form of pulses or *bits* of information rather than in a continuous wave form) will provide new flexibility in meeting both voice and high-speed data communications needs.

Among the steps taken in 1981 toward building this end-to-end digital network:

–We continued to add large digital electronic switching systems to the long distance part of the network. Seventy of these big No. 4 ESS systems were in operation at year's end, handling large volumes of voice traffic and data communications.

–We are testing a Western Electric-made local digital switching machine, the No. 5 ESS, for service in Seneca, Ill. This new system is designed to be used in a range of central offices: small, rural telephone exchanges, where there might be no more than a few hundred lines, to larger urban exchanges with as many as 100,000 lines. In addition, we have begun using a local digital switching system manufactured by Northern Telecom, Inc.

–We started constructing the largest high-speed digital coaxial cable system, 2,300 miles from Plano, Ill. to Sacramento, Cal. Capable of carrying 140 million bits of information per second, it could transmit the contents of a newspaper in the blink of an eye.

–New digital microwave radio systems went into service, and exploratory work is under way on digital radio systems for long-haul use.

–We continued to extend digital technology to our local underground and aerial cables, which connect customers to a local central office.

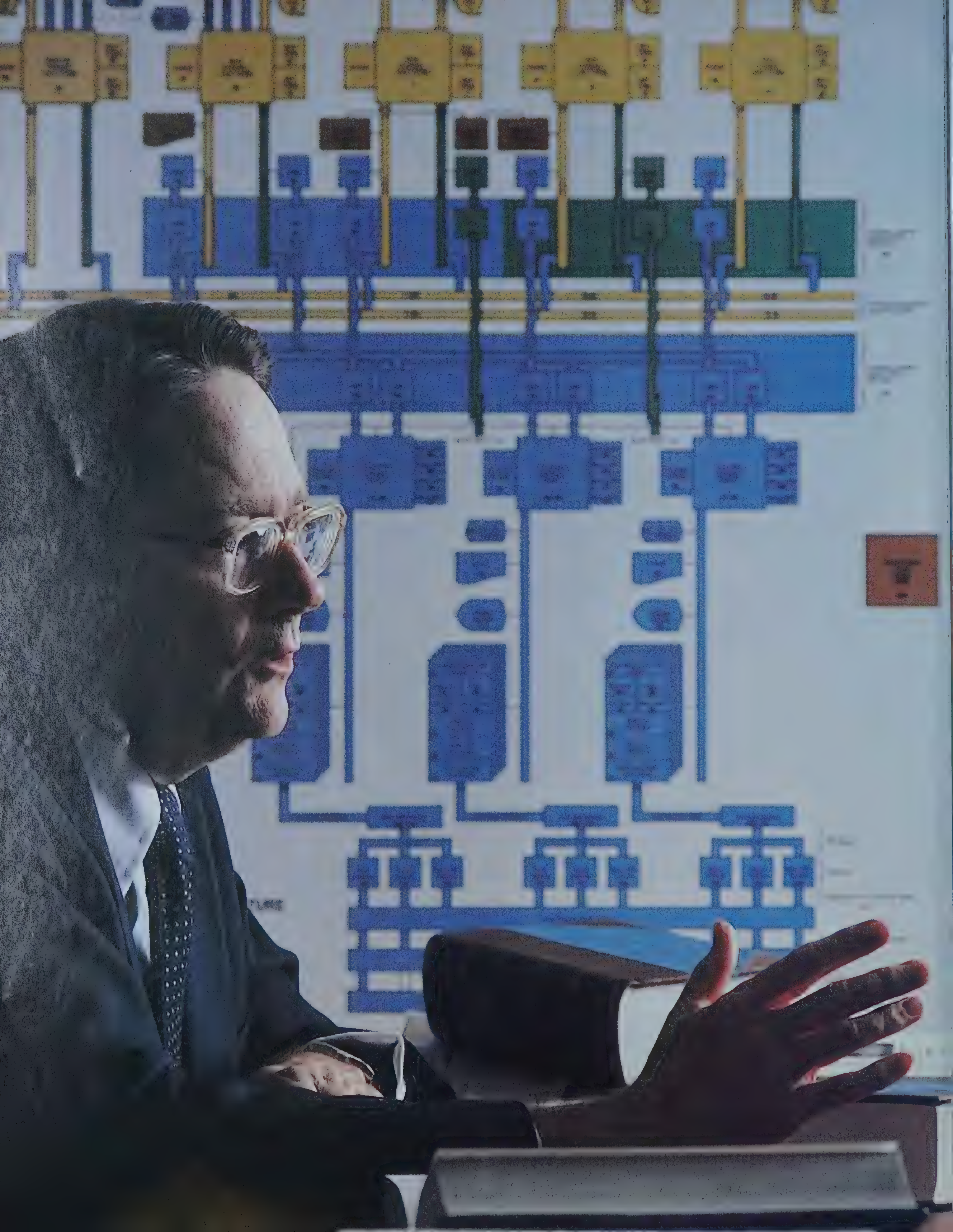
–And we started integrating into the network a completely new type of central office terminal system: Digital Access Cross-Connect System. It uses microprocessors to assign, rearrange and test private line circuits.

Lightwave communications is an important link in the developing chain of network digital facilities. With a lightwave system, information is transmitted in the form of light pulses over strands of hair-thin glass fibers rather than as electrical pulses on copper conductors. The cables enclosing the glass fibers are only about a half-inch in diameter, much smaller and lighter than copper cables and more efficient and economical to use in underground duct space.

It was little more than five years ago that the Bell System tested an experimental lightwave system at the Bell Laboratories-Western Electric facility in Atlanta. Since then, we have been moving ahead to add lightwave systems to the array of other transmission facilities in the network. Capital expenditures for lightwave projects were increased from $7.4 million in 1980 to $80.5 million in 1981.

By the end of the year, 16 Bell System lightwave routes were in service in metropolitan areas and others were in the works. Construction started in June on the world's largest laser-powered lightwave system, a 776-mile project extending from Massachusetts to Virginia. The first leg, for which FCC approval has been obtained, is scheduled for operation in 1983. It will go from Washington through Philadelphia to New York City.

Another project, this one on the West Coast, will interconnect all of California's major metropolitan areas with a lightwave system by 1985. Meanwhile, we are working with government telecommunications agencies in Europe to use lightwave technology for an undersea cable system across the Atlantic in the late 1980's.



"In the future, even the smallest businesses will be able to use the extensive data communications services enjoyed today only by the largest corporations. Data communications services will be as accessible and easy to use as the telephone itself."

William R. Smith
Director-Project Implementation, AT&T Long Lines

New Markets to Serve

A few years after World War II's end, an AT&T advertisement pictured a boy asking the question, "What will the telephone be like when I grow up?" At the time, the Bell System had only about 33 million telephones in service, it still took an operator to make a long distance call and telephone lines were for talking and little else.

Both the boy and the telephone have long since grown up to become part of the Information Age.

At the end of 1981 there were 142.4 million Bell System-owned telephones in service. All but 3.9 percent of the long distance calls placed during the year were dialed directly. And telephones and telecommunications systems had become increasingly essential to the effective management and distribution of information by voice, data and "images" ranging from television pictures to computer graphics.

In the past, the Bell System was driven by one principal goal: making telephone service available to everyone, everywhere in the nation, to anywhere in the world. For all practical purposes, we were serving a single market, best met by a standard service.

Today, with even remote rural areas linked to the nationwide telecommunications network, we are challenged to develop and offer new products and services to a nation of consumers that has come to expect more from the telephone than telephone service.

In this new era, there are many markets.

More Opportunities Ahead

The future holds promise of still more opportunities: to provide components and systems for the high technology "office of the future;" to participate in the provision of videotex services, electronic information systems linking homes to computerized data banks; to explore new international markets; and to offer the public a higher quality mobile telephone service.

We are planning to pursue or already are engaged in aspects of each of these emerging markets–while, at the same time, we have been improving today's service to both home and business customers.

"This is the age of the 'smart phone.' Customers expect the telephone set and telephone lines to serve new purposes, accomplish new tasks."

R. D. Daniel
PhoneCenter Supervisor, South Central Bell

A trial of an electronic home information service provided jointly in Florida by Knight-Ridder Newspapers and AT&T came to a close in 1981, and plans were announced by Knight-Ridder to begin an expanded commercial market test of the system in 1983. Using Bell System terminals and communications facilities, participants in the trial had access to the data base supplied by Viewdata Corporation of America, a Knight-Ridder subsidiary. The two-way capability of the service enabled them to perform shopping and banking transactions from their home terminals.

In the fall of 1982, CBS Inc. and AT&T will begin a seven-month test of another videotex system in New Jersey. CBS will provide the information content, and we will provide the host computer facilities, the telecommunications lines and the home terminals.

Until recent years, getting a telephone or having one repaired required calling the company and negotiating an appointment for an installation or repair visit. For the customer of the 1980's, this approach to service often is less than convenient. For the company and the customer, it is costly.

As a result, the Bell System has sought new and better ways to serve its customers.

Approximately 80 percent of all our residence telephones are now acquired by customers through our retail PhoneCenters. We have been steadily replacing the traditional home connecting arrangements with simple plug-in jacks; four of every five homes and apartments served by Bell companies currently have this new modular outlet.

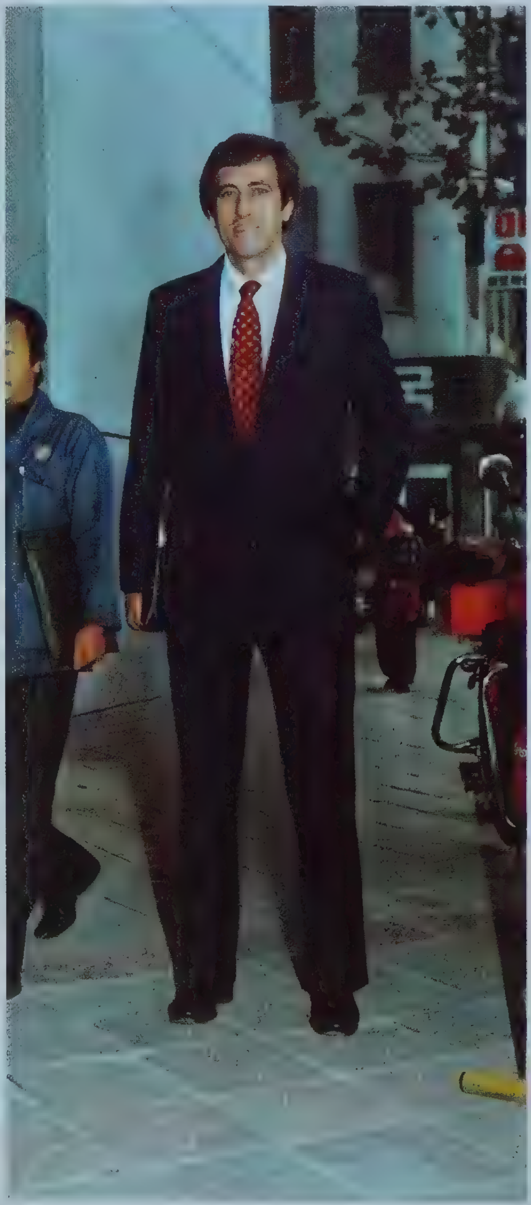
Residence customers shopping for telephones look for convenience features and a choice in style.

Responding to these customer interests, we offer sets like the Touch-a-matic® telephone, which can store up to a dozen prerecorded numbers in its electronic memory for quick, one-touch calling. We also continued in 1981 to add new Design Line® decorator telephones. And we are conducting consumer tests to determine what customers want in the way of still newer features and designs.

Focusing on Business

Businesses, large and small, depend on information and communication systems for timely, accurate information to guide them in decision-making, to improve productivity and to help manage scarce resources. In response, we have been developing and marketing information systems–industry by industry, customer by customer. Our aim is to offer the appropriate mix of hardware and software solutions to business problems with state-of-the-art products and services.

The first enhanced service we plan to offer under the FCC's Second Computer Inquiry guidelines is Advanced Communications Service. This service would provide communications processing and storage capabilities,



"Our prospects internationally are outstanding. The Bell System's name, the respect for our technology and the fact that we are not just a vendor of equipment but that we have operating experience –these make up our competitive edge."

Timothy R. Schrader
Managing Director-Far East,
AT&T International

"It's exciting to be part of an organization that will serve one of the emerging telecommunications markets. Many people have been waiting for quality mobile telephone service for years, and cellular technology can give it to them."

Joey Wolff
Director of Marketing, Advanced Mobile Phone Service

manage data communications networks and transport data. It would give users a data communications network ready for use on demand, with payment keyed to usage. The service is designed to allow otherwise incompatible terminals and computers to communicate with each other.

We continued to develop and improve software packages that, as part of our line of Dimension® PBX systems, enable industries and businesses to conduct their operations more efficiently and economically. One software-based service, for example, helps medium-size hospitals in managing patient admissions, monitoring diets, assigning rooms and the like. Others are being used in the hotel industry and elsewhere to help control energy costs and to provide billing information.

For smaller businesses, we introduced a new version of our Horizon® communications system.

We have proposed a video teleconferencing service–Picturephone® meeting service–that would be available in 16 cities in 1982, 42 cities by the end of 1983. Business people using the service would be able to hold face-to-face meetings over a two-way hookup between conference rooms, without having to travel to a distant city for the meeting.

Shortly after receiving FCC approval to provide transmission services to the broadcasting companies by satellite, we began offering nationwide distribution of network television programs over the satellite circuits we lease from Comsat General Corporation. New Telstar 3 satellites, currently being built, will be owned and operated by AT&T. The first of three is scheduled to be launched in 1983.

Behind the scenes, we continued to expand our trouble-reporting and repair operations. Field Assistance and Support organizations are in place throughout the country to help handle unusual service problems, while specialists provide remote testing analysis and technical expertise to resolve problems quickly.

International Markets

AT&T International celebrated its first anniversary in 1981, having completed consolidation of our international subsidiaries into a single organization.

It was not until recent years that the Bell System decided to reenter the international marketplace and to export the products of its technology and manufacturing resources as well as its operating experience to other countries. Now we have begun producing and engineering products and services that are especially tailored to meet foreign technical and operating standards. In short, we have started offering a truly world class product line.

In 1981, for example, a Western Electric-made No. 4 Electronic Switching System went into service in Taiwan with signaling and other features tailored to meet the unique needs of our customers there. Fourteen other electronic switching systems–the No. 1A ESS–have been sold to and installed in Saudi Arabia and South Korea.

AT&T International also announced the availability of a world class family of telephone sets designed specifically to work with overseas telephone systems as well as in the U.S.

Mobile Service

A cellular system conceived by Bell Laboratories to provide high quality and widely available mobile communications service offers the promise of a greatly expanded market in telecommunications. With this technology, mobile telephone service is expected to grow rapidly in the years ahead, its customers projected to increase from today's 150,000 to about 1.5 million by the end of the decade.

The new system, which we have tested successfully for three years in Chicago, offers a transmission quality that is equal to that of regular telephone service and has far greater capacity than current mobile phone systems. Capacity is increased by dividing a service area into a number of small, contiguous "cells" equipped with low-power antennas that permit scarce radio channels to be used over and over. The mobile call is automatically handed off from cell to cell.

In December the FCC reaffirmed a decision reached earlier in the year opening the way for Bell and other carriers to offer service based on cellular technology. We believe the service can be available in 35 major market areas within five years.

A Market Leader

One word describes the biggest change that has taken place in this industry in recent times: competition.

For most of the industry's history, government regulation–not competition–was the rule. But in the 1970's, reflecting a major change in FCC policies, other common carriers and suppliers of telecommunications equipment gradually began entering the business in competition with the established telecommunications companies.

In a number of respects, including pricing, the Bell System–both the local units and the Long Lines Department–found itself at a competitive disadvantage in an environment of regulated competition. But with structural changes, together with changes in accounting methodologies and cost allocations used in establishing rates for regulated services, we will be in a better position to compete with companies that from the beginning have been relatively free of regulatory constraints.

Today, competition exists in nearly all parts of the business, and it is growing each year.

More than 2,300 domestic and foreign companies–ranging from big, high-technology corporations to smaller, more specialized firms–are producing telecommunications products: everything from telephones to highly sophisticated terminal gear. The Bell companies already look to such other suppliers to fulfill many of their own needs. Over one-third of the plant added by the Bell System in 1981 was provided either directly or indirectly by general trade manufacturers.

More than a hundred companies, including resellers of service, provide or plan to offer long distance type services reaching most of the nation's metropolitan areas. Radio common carriers, providing mobile services, also compete with the telephone companies.

The Bell System has felt the effects of competition. But just as competition is growing, so too are our markets.

We expect to operate profitably and effectively in this expanding marketplace. We will do so by offering products and services that are high in

"The group I'm in handles Special Services only. That's our business and that's what we know. I take pride in my job, and the people I've worked with perform with professionalism."

Bernard E. Simpkins
Services Technician,
New Jersey Bell

"We are continually looking for new ways to serve large business customers better. This is a very competitive part of the industry, but we're showing what good competitors we can be."

Jean DiNova
National
Account Executive,
Northwestern Bell

"We've always had topflight engineering departments. What is changing is that we now give equal emphasis to marketing. We are more market-oriented."

Gordon B. Smith
Engineer, Indiana Bell

quality, provided professionally and priced competitively–in short, by being a market leader.

Accent on Marketing

Intelligent marketing now guides and unifies our efforts in every aspect of the management of our business–an approach increasingly apparent to and welcomed by our customers. About half of all the management people hired in 1981 filled marketing and sales support assignments.

We intend to market all our services vigorously, including those subject to traditional regulation as well as those which would be offered in a detariffed or deregulated part of the business. Indeed, we established a separate organization in 1981 to focus on the marketing of our regulated network services.

To ensure the professional development of our business sales people, we have instituted a certification program for Bell System Account Executives and an evaluation and development program for sales managers. We opened a national sales training center, the first of its kind in the Bell System. We also introduced a new incentive pay plan, similar to plans used by other companies to attract and motivate their sales forces.

Our most demanding customers are the large users of telecommunications and information services, including businesses that operate nationally and have multistate locations. Uniquely qualified Bell System Service Managers work with National Account Executives to respond to the needs of these customers. Our aim is to develop, deliver and support products, services and systems that meet the requirements of these customers better than they can be met elsewhere.

A Reputation for Quality

Over the years the Bell System has been widely recognized as an organization committed to providing good service. We expect to live up to–and build on–that reputation.

Judged by customer evaluations as well as our own internal measurements, the overall quality of Bell System service in 1981 remained high, in some respects better than ever.

Providing top quality service means having facilities ready as the public's demand for service grows.

"The idea behind network management is to make the most productive use possible of our facilities and to keep the system working smoothly even in times of emergencies."

Cathy Damuth
Assistant Staff Manager, Mountain Bell

Approximately 56 percent of the $18.1 billion we spent in 1981 for construction was attributable to growth, the rest to modernization, customer movement and plant replacement.

We are making a concerted effort to speed up installations and make other immediate and long-term operating and administrative improvements in the way Special Services are provided and maintained. Special Services–for example, providing dedicated circuits that link our customers' computer centers–are a large and growing part of our business.

We established a new group in our Network Services organization to help ensure that the needs of other common carriers that rely on Bell exchange facilities to provide customer access to their own lines are fully met. One of the driving forces behind Congressional and FCC efforts to restructure the industry has been the issue of access to our local exchange lines. After the divestiture, the local exchange companies would provide access to AT&T and others on equal terms and conditions. In turn, the new Consent Decree provides for the payment of access charges by AT&T and other intercity carriers to the divested local exchange companies.

Pricing and Productivity

In a fully regulated environment, with little or no competition, telephone pricing policies were clear-cut. Basic telephone rates were set at levels that were easily affordable by the general public. To accomplish this, rates for other services, like long distance, contributed disproportionately to the common costs of running the business.

But with competition come marketplace and regulatory pressures to align costs and prices more closely and to recover capital costs more quickly. The practical effect of these new pressures will be to raise the relative level of basic local charges.

The telephone companies–as much as regulators or legislators–are determined to keep local telephone rates within the economic reach of all. The access charges to be imposed on long distance carriers will help achieve this objective.

Also, for people who make few calls, the charge for having a local line can be separated from charges based on how much that line is used.

Another approach is to offer customers a variety of pricing options–a reduced basic rate for low usage; the new customer-dialed Calling Card service; charging long distance calls on the basis of an initial one-minute period instead of three minutes; a higher discount for evening interstate calls, and so on.

In terms of the hours of work it takes to pay for a month's local service, the cost of residential telephone service in the U.S. is now at an all-time low. Even though telephone rates have been going up, the average working time needed to pay for a month's basic local service at the beginning of 1981 was only about one and a quarter hours; in 1940 it was nearly six hours.

Moreover, the price of telephone service has gone up less than consumer prices generally during this period. A rate of productivity improvement in the Bell System that has been significantly stronger than that of the economy as a whole has helped to offset the effects of inflation and slow the pace of rate increases. In turn, our productivity gains reflect the Bell System's broad use of computerized systems to manage and operate the business and the investment of sufficient capital to support new technology, promote mechanization and increase efficiency.

Telecommunications in Transition

New technologies. Information Age markets. Increasing competition.

These are the major elements of change in our business, and it is to take them into account that in recent years a new national telecommunications policy has been evolving.

The nation's communications goals were established almost half a century ago in legislation enacted "to provide for the regulation of interstate and foreign communication by wire or radio." That was 1934.

Over roughly the last decade, a different national policy has been taking shape, one matched to a new time and new technology. This changed policy looks more to marketplace forces than to regulation to serve the public interest.

In 1981 Congress and the FCC took steps toward implementing this policy. Although there were important differences in their approach to lessening regulation and restructuring the industry, both took a common direction: to keep basic local and long distance services fully regulated while detariffing or deregulating other services.

The terms of the new Consent Decree are consistent with the intent of Congress and the FCC, and satisfy many of the concerns they have expressed. With the Decree, we have undertaken to conform ourselves to this new national telecommunications policy.

Congress

In early October the U.S. Senate, by a vote of 90 to 4, passed the "Telecommunications Competition and Deregulation Act of 1981." The bill, S. 898, had been approved earlier by the Senate Commerce, Science and Transportation Committee, chaired by Senator Bob Packwood (R-Ore.).

In our view, the bill imposes tougher restraints on Bell System operations than are consistent with the idea of full and fair competition. Still, in many respects, it contains positive and workable approaches to issues that have long troubled the industry.

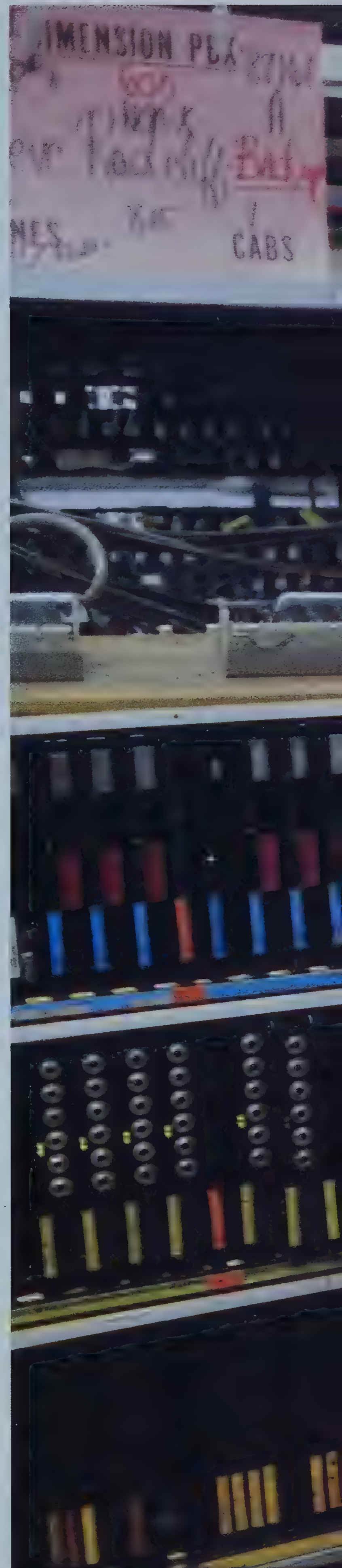
In December the draft of a more

"I can see the opportunities ahead. And opportunities for the company should mean opportunities for the individual employee."

David R. Modisette
Planning Engineer, Western Electric

"No matter what changes occur in the way our services are provided and priced or in the way we are structured, we have to retain a sense of public obligation. And I know we will."

Walter A. Alford
Vice President, Southern Bell



burdensome bill was introduced in the House of Representatives by Congressman Timothy Wirth (D-Colo.), chairman of the House telecommunications subcommittee.

The House measure–H.R. 5158–would go well beyond the Senate bill in placing restraints on our ability to compete. On the one hand, the bill would enlarge the regulatory authority and discretionary power of the FCC and, on the other, establish significant competitive handicaps that apply only to AT&T.

Clearly, both the Senate and House bills were constructed to apply to an industry structure significantly different from the one that would be created by AT&T's divestiture of the local operating companies. In fact, the Consent Decree would seem to simplify the task of updating the Communications Act of 1934. Its provisions mesh well with Congress' efforts to preserve quality, reasonably priced local service; encourage competition; remove the potential for cross-subsidies; insure national defense and security needs, and promote the viability of the U.S. in foreign markets.

The FCC

While efforts continued in Congress to pass legislation, the FCC was going forward with its own plans to restructure the industry. The Commission issued a modified order in its Second Computer Inquiry, an order distinguishing between basic local and long distance services on the one hand, and enhanced services and customer premises equipment on the other.

According to the FCC order, the former would remain regulated while the latter would be detariffed; that is, the filing and approval of tariffs for the latter services no longer would be required before they could be offered or their prices changed.

In regard to customer premises equipment, the Commission ruled that newly manufactured or acquired equipment could be offered by AT&T only through a fully separated subsidiary; but, pending further study, "embedded" equipment would remain tariffed and, therefore, the responsibility of the Bell operating companies.

Detariffing, formerly set to begin on March 1, 1982, was postponed by the FCC until January 1, 1983.

It is considered likely that the Commission will reexamine the Second Computer Inquiry order in light of the proposed Consent Decree modification which, among other things, requires divestiture of our local exchanges.

The Courts

In U.S. District Court in New Jersey, Judge Vincent P. Biunno ruled in September that the 1956 Consent Decree, which originally had been filed in that court, did not prohibit us from furnishing enhanced services or customer premises equipment as prescribed in the FCC's Second Computer Inquiry.

(The 1982 Decree was filed in this same court and subsequently transferred to the Federal District Court in Washington, D.C., where the antitrust trial was being held.)

In other judicial matters, decisions had not been reached at year's end in our appeals of lower court jury verdicts against us in cases brought by MCI Communications Corp. and by Litton Industries.

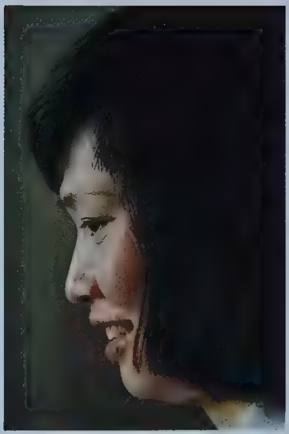
Unchanged Commitments

In a statement of policy issued in 1981, we pledged ourselves "to change–or to remain unchanged–in whatever ways will assure that through the 1980's our business continues to be an enterprise useful to its customers, profitable to its proprietors and to its employees worth working for."

With regard to restructuring, we believe our decision to accept the government-proposed Consent Decree meets these criteria.

It was with this commitment in mind, too, that in 1981 we reaffirmed in a statement of consumer rights our responsibilities to customers. In this new era, as in the old, our success will be decided by how well we meet those responsibilities.

Over the long run, it is our commitment to service that requires us to earn at a level that will justify the continuing confidence of investors in our business. So our financial policies must be aimed at protecting the interest of our share owners and maintain-



"As I see it, the focal point of corporate strategy is to increase the worth of our share owners. With new opportunities will come risks. But if we manage well, we'll be profitable."

Lily K. Lai
Division Manager-Financial Management, AT&T

The following are the main points of the Consent Decree signed on January 8, 1982.

- AT&T must divest those parts of the 22 Bell System operating companies that provide local exchange or local access services.
- AT&T retains its Long Lines Department and the long distance network; Western Electric; Bell Laboratories; and customer premises equipment (such as telephones and switchboards).
- Constraints imposed on AT&T by the 1956 Consent Decree are removed.
- AT&T's share owners retain their stock in AT&T but will also own proportionate values in the local exchange companies.
- Divestiture of local exchange and local access services would take place 18 months after the Consent Decree's effective date.
- A plan for the reorganization of the Bell System to accommodate this divestiture will be filed with the Department of Justice within six months of the effective date.
- Employee pensions, wages and benefits remain unchanged, and all collective bargaining agreements continue in force.

ing the integrity of their investment.

With regard to competition, we have said that we seek no advantage in the marketplace except through performance, and that we shall be fair competitors. Not even by inadvertence do we want to provide our competitors a basis for questioning the integrity with which this business is conducted.

Surveys show that the Bell System continues to be seen by the public and our employees as a good place to work. We value that reputation and we mean to keep it–by retaining those things that make this a good place to work and changing those that don't.

We are especially mindful of employee concerns at this time because of our restructuring plans. Indeed, we already had taken some steps in connection with changes that were taking place in the business prior to the filing of the Consent Decree.

For example, programs have been set up to afford employees an opportunity to participate in job and organizational changes. We seek to encourage employees, wherever practical, to take part in the planning and decision-making affecting their jobs. Also, Quality of Work Life Committees, a joint union-management venture, encourage employee participation in furthering job satisfaction and increasing the effectiveness of the organization. And new attention is being devoted to giving managers increased responsibilities and broader spans of control.

Also unchanged are our commitments to equal employment opportunity, affirmative action and the employment of disabled persons.

At year's end, total Bell System employment stood at one million, down 3,900 from the year before.

It is estimated that after the divestiture required by the Consent Decree about half of all current Bell System employees will work for the local exchange companies, the other half for AT&T and its associated units.

The nationwide public telecommunications network, whose management and operation play so large a role in Bell System activities, is an essential part of the economic and social life of the nation. Moreover, it is–as the Defense Department has made clear–a vital element in the nation's security and its preparedness for emergencies.

This public interest aspect of our business has long been an intrinsic consideration in our planning–whether it is planning for regular telephone service, for developing complex government communications systems or–as in 1981–for providing special communications links for the inauguration of a President, the release of 52 American hostages from Iran or the two flights of a space shuttle called Columbia.

Another of the Bell System's unchanging commitments has been to the communities in which its companies operate. In part, this commitment has been a financial one. In 1981 AT&T and the Bell companies contributed some $45 million toward the support of charitable, health, educational, cultural and civic groups, an increase of 18 percent over the previous year.

This was the third year of our participation in American Orchestras on Tour, a program to fund visits of major American orchestras to cities and towns throughout the country. This program is a particularly appropriate one for the Bell System, which for so many years sponsored the *Bell Telephone Hour.*

Looking back on 1981, a year of transition for the Bell System, management wishes to acknowledge the contribution made by the members of AT&T's Board of Directors and of the Boards of the other Bell units. Individually and through committees, they endeavored at every turn to assist the company in meeting its earnings and service responsibilities, in identifying and adapting to changed public policies and in honoring what Bell System people long ago accepted as an unusual obligation to the public.

"We have the potential to become much more than we are today, in the same way that we are much more today than we were 25 years ago."

James C. Armstrong
Director-Strategic Planning, AT&T

Satellite earth station, Three Peaks, California

Financial Review and Consolidated Financial Statements

Report of Management

The financial statements on pages 30 through 43, which consolidate the accounts of American Telephone and Telegraph Company and its subsidiaries, have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission for telephone companies, except for investments, revenue refunds, and a California rate and tax matter as discussed in Notes to Financial Statements.

The integrity and objectivity of data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management as is all other information included in the Annual Report unless indicated otherwise. To this end, management maintains a system of internal accounting controls which, on an ongoing basis, is reviewed and evaluated. Our internal auditors monitor compliance with it in connection with their program of internal audits. However, there are inherent limitations that should be recognized in considering the assurances provided by any system of internal accounting controls. The concept of reasonable assurance recognizes that the costs of a system of internal accounting controls should not exceed, in management's judgment, the benefits to be derived. Management believes that the Company's system does provide reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and are recorded properly to maintain accountability for assets and to permit the preparation of financial statements in conformity with generally accepted accounting principles applicable to rate-regulated utilities. Management also believes that this system provides reasonable assurance that access to assets is permitted only in accordance with management's authorizations, that the recorded accountability for assets is compared with the existing assets at reasonable intervals, and that appropriate action is taken with respect to any differences. Management also seeks to assure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility, and by communications programs aimed at assuring that its policies, standards and managerial authorities are understood throughout the organization.

These financial statements have been examined by Coopers & Lybrand, independent Certified Public Accountants. The other auditors referred to in their report are Arthur Young & Company, auditors of Western Electric Company, Incorporated and Southwestern Bell Telephone Company, and Arthur Andersen & Co., auditors of Illinois Bell Telephone Company.

The Audit Committee of the Board of Directors, which is composed of Directors who are not employees, meets periodically with management, the internal auditors, and the independent auditors to review the manner in which they are performing their responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have free access to the Audit Committee at any time.

R. N. Flint,
Vice President and Comptroller

Report of Independent Certified Public Accountants

To the Share Owners of American Telephone and Telegraph Company:

We have examined the balance sheets of American Telephone and Telegraph Company and its subsidiaries as of December 31, 1981, 1980 and 1979, and the related statements of income and reinvested earnings and sources of funds supporting construction activity for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of two telephone subsidiaries and of Western Electric Company, Incorporated, the Company's principal unconsolidated subsidiary, were examined by other auditors; such statements reflect net income constituting approximately 27%, 28% and 27% of consolidated net income for 1981, 1980 and 1979, respectively. The reports of the other auditors have been furnished to us and our opinion expressed herein, insofar as it relates to amounts included for subsidiaries examined by them, is based solely upon such reports.

In our previous report dated February 6, 1981, our opinion on the 1980 financial statements was subject to the effects, if any, on the 1980 financial statements of the inclusion in net income for 1980 of amounts resulting from intrastate rate increases which were collected subject to refund. As discussed in Note (H) to Financial Statements, such amounts are no longer considered material due to the resolution of various intrastate rate matters since that date. Accordingly, our opinion on the 1980 financial statements is no longer subject to the outcome of these matters.

In our opinion, based upon our examinations and the reports of other auditors, the financial statements referred to above present fairly the financial position of American Telephone and Telegraph Company and its subsidiaries at December 31, 1981, 1980 and 1979, and the results of their operations and sources of funds supporting their construction activity for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand
1251 Avenue of the Americas, New York, NY
February 8, 1982

Results in Brief

Selected Financial Data

DOLLARS IN MILLIONS (except per share amounts)		1981	1980*	1979*	1978*	1977*
Revenues	Local service	$ 25,553	$ 22,449	$ 20,208	$ 18,685	$17,007
	Toll service	30,248	26,133	23,371	20,770	18,094
	Other (including other income)	3,428	3,173	2,604	2,289	1,902
		59,229	51,755	46,183	41,744	37,003
Expenses	Operating	39,346	34,305	30,236	26,527	23,546
	Income taxes on operations	4,202	3,696	3,607	3,826	3,252
	Other operating taxes	4,430	3,928	3,602	3,439	3,252
	Interest	4,363	3,768	3,083	2,690	2,487
		52,341	45,697	40,528	36,482	32,537
Net Income		6,888	6,058	5,655	5,262	4,466
Preferred dividend requirements		146	150	156	164	184
Income applicable to common shares		$ 6,742	$ 5,908	$ 5,499	$ 5,098	$ 4,282
Earnings per common share		$ 8.55	$ 8.17	$ 8.01	$ 7.73	$ 6.84
Based on average shares outstanding (in thousands)		788,178	723,516	686,109	659,843	625,878
Total assets		$137,750	$125,553	$113,444	$103,025	$93,677
Long and intermediate term debt		$ 43,877	$ 41,255	$ 37,168	$ 34,203	$32,205
Preferred shares subject to mandatory redemption		$ 1,563	$ 1,575	$ 1,588	$ 1,600	$ 1,625
Convertible preferred shares subject to redemption		$ 336	$ 385	$ 433	$ 501	$ 594
Dividends declared per common share		$ 5.40	$ 5.00	$ 5.00	$ 4.60	$ 4.20
Ratio of earnings to fixed charges†		3.26	3.32	3.67	4.00	3.76

Selected Operating Data (In Millions)

For the year ended December 31	1981	1980	1979	1978	1977
Toll messages	18,602	17,457	16,193	14,639	12,844
WATS messages	5,655	4,874	4,244	3,631	3,046

Charges for toll messages and WATS messages for the year ended December 31, 1981 account for about 38% and 8%, respectively, of total billed operating revenues.

At December 31	1981	1980	1979	1978	1977
Company-owned telephones in service	142.4	141.7	138.2	133.4	128.5
Network access lines in service	84	82	79	76	73

Recurring charges for company-owned telephones in service and access lines in service for the year ended December 31, 1981 account for about 22% of total billed operating revenues.

*Restated for compensated absences. See Note (E) to Financial Statements for explanation.

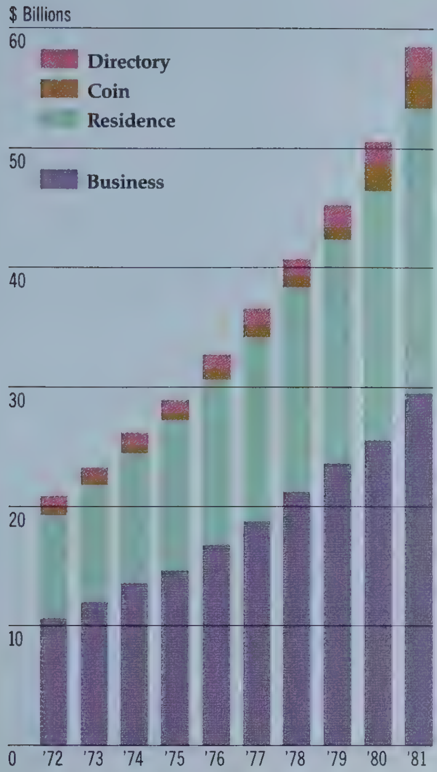
†For the purpose of this ratio: (i) earnings have been calculated by adding to income before interest expense the amount of related taxes on income, ownership interest of others in the net income of certain consolidated subsidiaries and the portion of rentals representative of the interest factor, and by deducting therefrom the consolidated subsidiaries' share in the income in excess of dividends of companies accounted for on an equity basis; (ii) fixed charges comprise total interest expense, dividends on preferred shares of a consolidated subsidiary held by others and such portion of rentals representative of the interest factor. The ratios shown would not change materially if the earnings and fixed charges of companies accounted for on an equity basis were included in the computations.

Management's Discussion and Analysis of Financial Condition and Results of Operations

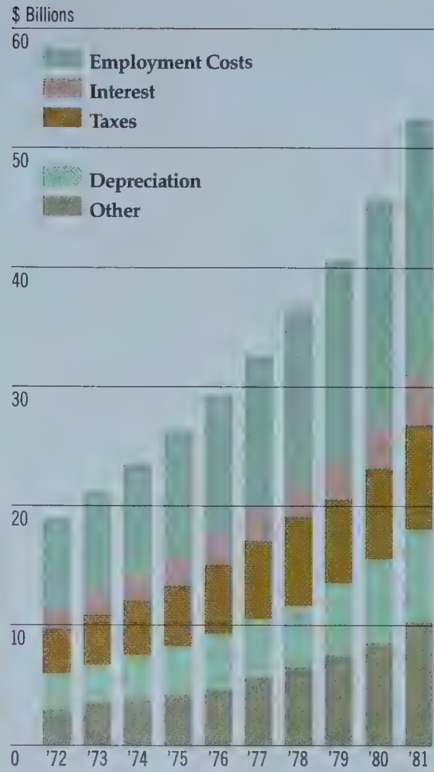
In a year of up and down economic conditions, AT&T's financial results improved.

Total revenues (including other income) for 1981 showed a year-over-year increase of 14.4 percent, compared to 12.1 percent in 1980 and 10.6 percent in 1979. Total expenses (including operating taxes and interest) increased 14.5 percent in 1981, compared to 12.8 percent in 1980 and 11.1 percent in 1979. Net income in 1981 rose 13.7 percent, compared to a 7.1 percent rise in 1980 and 7.5 percent in 1979.

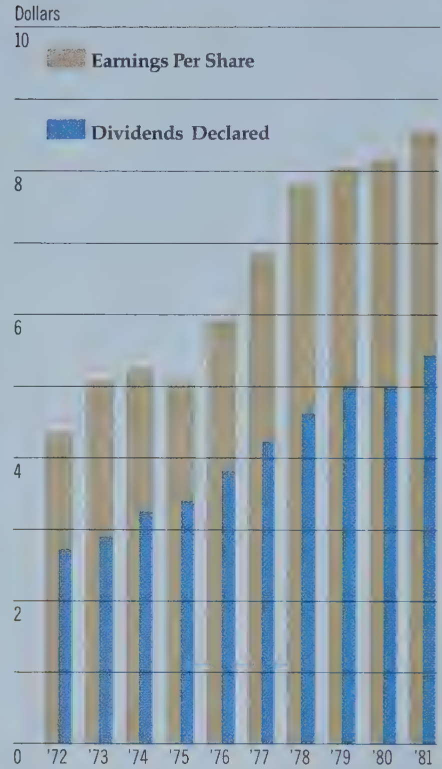
Local and toll service revenues rose 14.9 percent in 1981, 11.5 percent in 1980 and 10.5 percent in 1979, in part as the result of growth in calling volumes and access lines in service and in part because of rate increases. Toll messages grew 6.6 percent in 1981, compared to 7.8 percent in 1980 and 10.6 percent in 1979. Wide Area Telecommunications Service (WATS) messages grew 16.0 percent in 1981, compared to 14.8 percent in 1980 and 16.9 percent in 1979. Bell System companies added 2.1 million access lines during 1981, compared to 2.5 million access lines



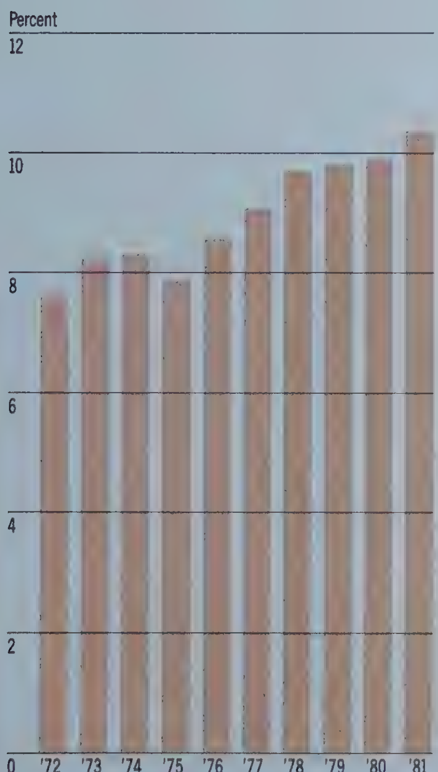
Revenues: Business services provided 52 percent of Bell System operating revenues in 1981, while residence services contributed 41 percent. Together, they accounted for $6.9 billion of the year's $7.4 billion growth in operating revenues.



Expenses: Total expenses in 1981 amounted to $52.3 billion, an increase of 14.5 percent over 1980. Employment costs were $21.4 billion, interest costs $4.4 billion, operating taxes $8.6 billion and depreciation expenses $7.9 billion.

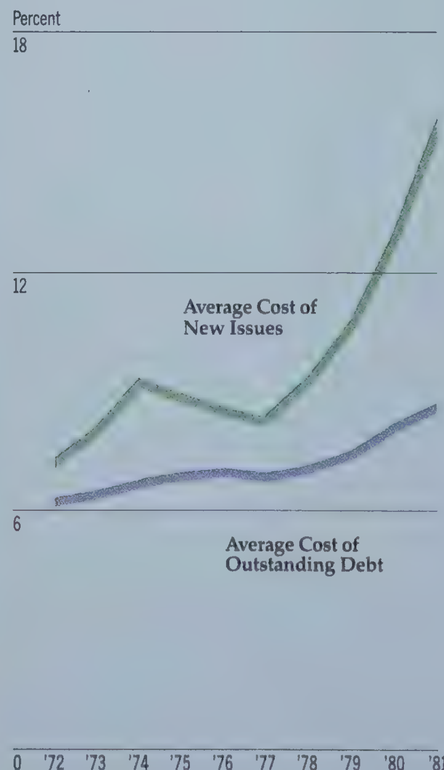


Earnings per share: Despite renewed recession and large depreciation increases not yet fully recovered through repricing, earnings per share were $8.55, up from $8.17 in 1980. The dividend rate was raised to $5.40, the eighth increase in 10 years.



Return on capital: Return on total invested capital increased for the sixth consecutive year, evidencing continued improvements in productivity and the recognition by regulators of higher investor requirements caused by inflation.

Financing: Internal sources provided 73 percent of Bell System capital requirements in 1981, up from 56 percent 10 years ago, reflecting liberalized Federal tax depreciation policies and larger reinvestment of retained earnings.



Cost of debt: Interest costs of Bell System debt issues reached new highs in 1981, although some easing was evident at year's close. Consequently, the average cost of all long and intermediate debt outstanding rose to 8.6 percent by the end of 1981.

in 1980 and 3.0 million access lines in 1979. Higher intrastate rates contributed $2.1 billion to the increase in revenues in 1981, $1.2 billion in 1980 and $450 million in 1979. Interstate rate increases of $729 million in 1981 and $327 million in 1980 also contributed to the increase in revenues. (There were no significant interstate rate increases in 1979.)

Inflation affected the Bell System's expenses as it would most other businesses (see also Supplementary Data on page 44), principally in salary and wage-related costs including those increases provided for in the August 1980 contracts with bargained-for employees. Over their three-year life, these contracts are expected to increase wage and benefit expenses by about 30 percent. Increased pensions and benefits, higher depreciation expenses, changed accounting for station connection costs, and the rising costs of materials and services also caused operating expenses to increase as follows:

DOLLARS IN MILLIONS	1981 over 1980	1980 over 1979	1979 over 1978
Wages and salaries, including cost-of-living adjustments	$2,358	$1,678	$1,696
Provision for pensions and other employee benefits	312	379	482
Depreciation due to:			
Revised rates and practices (See Note (A), page 36)	887	324	111
Expensing station connection costs (See Note (D), page 37)	(626)	–	–
Increased plant investment	599	585	479
Maintenance due to expensing station connection costs (See Note (D), page 37)	584	–	–
Materials, supplies and other payments	927	1,102	941
Total operating expense increase	$5,041	$4,068	$3,709

Total income taxes on operations increased 13.7 percent in 1981 and 2.5 percent in 1980 because of higher income before such taxes. Income taxes on operations decreased by 5.7 percent in 1979, principally because of a reduction in the corporate federal income tax rate at the beginning of that year.

Western Electric's net income, included in "other income," increased 2.6 percent in 1981, compared to 9.0 percent in 1980 and 13.3 percent in 1979. The lower rate of growth in 1981 is the result of a decline in its volume of business and the impact of inflationary cost pressures.

Interest costs incurred by Bell System companies again hit record highs in 1981 as the companies went to the debt market to help finance their construction programs. Interest costs on Triple-A Bell System long term issues sold in 1981 ranged from a low of 13.4 percent to a high of 17.2 percent. The average interest cost on long and intermediate term debt issued in 1981 was 15.5 percent, compared to 12.5 percent in 1980 and 10.3 percent in 1979. The Company's embedded cost of debt rose to 8.6 percent at the end of 1981 from 8.0 percent in 1980 and 7.4 percent in 1979.

The Bell System obtained 73 percent of its capital needs through internal sources in 1981 and about 65 percent in both 1980 and 1979. It obtained $6.6 billion in external long term financing in 1981. This includes a $600 million issue of 10-year notes by AT&T and $2.9 billion in 19 long and intermediate term debt issues by the consolidated subsidiaries; similar issues totaled $4.7 billion in 1980 and $3.4 billion in 1979. AT&T also raised $1.0 billion in new equity from an underwritten stock issue and $2.2 billion from the Dividend Reinvestment and Stock Purchase Plan and employee savings and stock ownership plans. In 1980 and 1979, these plans provided $1.9 billion and $1.7 billion in new equity, respectively. Average common shares outstanding increased 65 million in 1981, compared to increases of 37 million in 1980 and 26 million in 1979.

AT&T negotiated two-year revolving credit agreements with certain major United States banks in March 1981 to borrow at mutually agreeable rates up to $750 million with a commitment fee of 3/8 of 1% per annum on any unused portion. No part of this line of credit has been used.

The Bell System's debt ratio (debt as a percent of total debt and equity) declined in 1981 to 45.3 percent at year's end. It was 46.6 percent in 1980 and 46.2 percent in 1979. If preferred shares subject to mandatory redemption were included with debt, the ratio would be 46.7 percent for 1981, 48.2 percent for 1980 and 48.0 percent for 1979.

Construction growth was reduced by about $600 million in 1981 and will be reduced by about $1.6 billion in 1982 as a result of expensing certain station connection costs. To meet the demand for communication services and to improve existing services, construction expenditures are expected to total about $18.9 billion in 1982. The Bell System has been able to obtain the funds needed to finance its construction program and believes it will be able to do so in the future. It is expected that external debt and equity financing in 1982 will be between $4.5 and $5.0 billion.

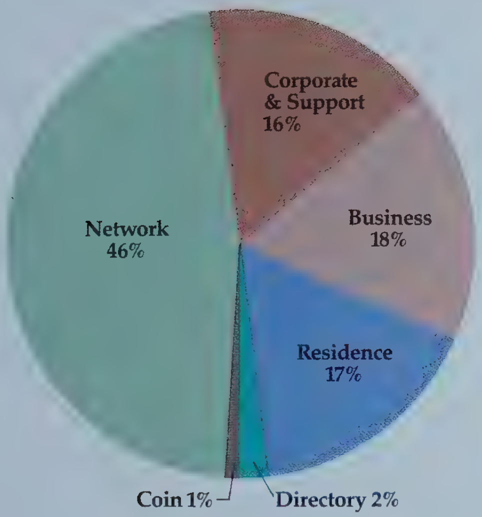
See Notes (A), (D), (F), (H), (I), and (V) to Financial Statements for matters pertaining to Depreciation, Accounting for Station Connection Costs, Provision for Pensions and Death Benefits, Rate and Related Matters, Interstate Revenues Tax, and Department of Justice Antitrust Action, respectively.

Market and Dividend Data

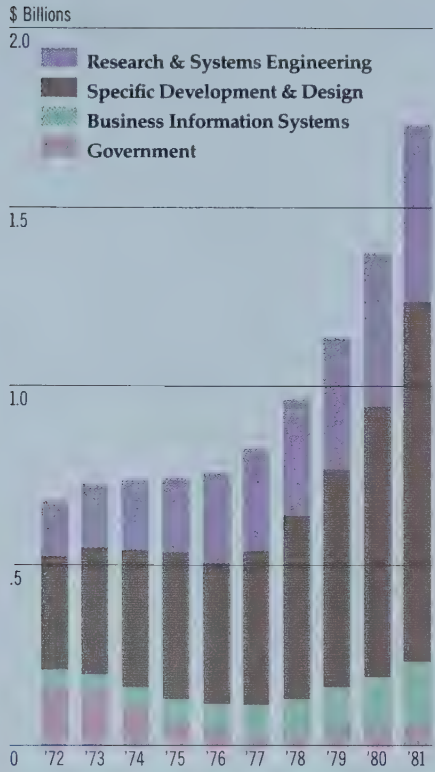
The principal market for trading in AT&T common stock is the New York Stock Exchange. As of December 31, 1981 there were 3,055,495 holders of record of this common stock. Market data as obtained from the Composite Tape* and dividend data for the last two fiscal years are listed below. The preferred shares rank prior to the common shares as to dividends. (See Note (M), page 41.)

Calendar Quarter		Market Price High	Market Price Low	Dividend Paid
1980	1st	$52 7/8	$45	$1.25
	2nd	55 3/4	48 1/4	1.25
	3rd	56 1/8	51 1/8	1.25
	4th	53 1/4	45	1.25
1981	1st	$53 1/2	$47 1/2	$1.25
	2nd	58 3/4	51 1/8	1.35
	3rd	60 1/8	53 7/8	1.35
	4th	61 1/2	57 1/8	1.35

*Encompasses trading on the principal U.S. stock exchanges as well as off-board trading.

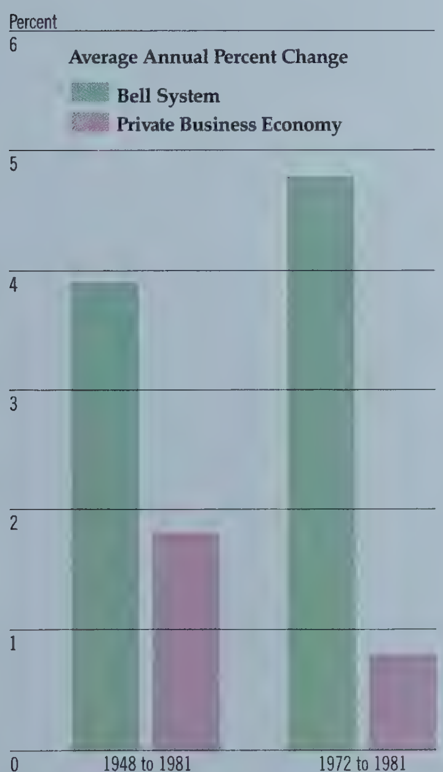


Employees: Nearly half of the Bell System's employees (excluding Western Electric and Bell Laboratories) were involved with the operation of the telecommunications network at the end of 1981, most of them in the Bell operating companies.

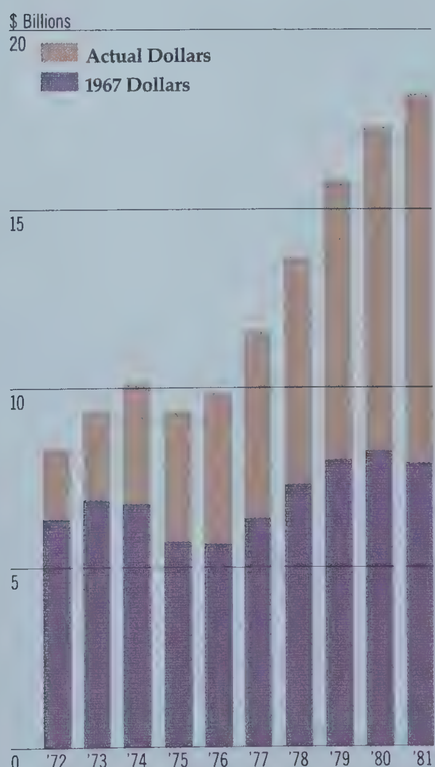


Research and development: Bell System R&D expenditures continued to grow substantially in 1981–totaling $1.7 billion, up $350 million over 1980–in recognition of the company's unchanging commitment to technological innovation.

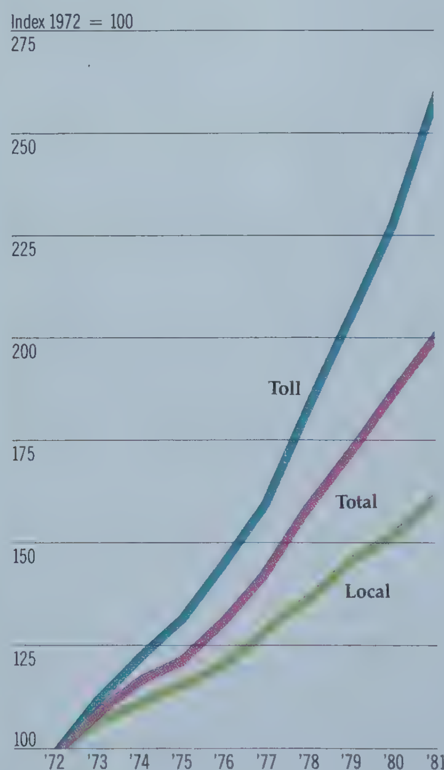
Prices: Over the past 10 years the Consumer Price Index rose about 120 percent. Local and long distance rates increased only 62 and 37 percent, respectively, an achievement made possible by continuing productivity gains and operating efficiencies.



Productivity: New technology and improved work methods led to productivity gains averaging almost five percent annually since 1972, well above the private business economy and better than our own performance over the post-1948 period.



Construction: Expenditures for growth and improvement of services totaled $18.1 billion in 1981, up $800 million from 1980. In constant dollars, construction outlays were slightly below last year's level, but almost 25 percent higher than 10 years ago.



Volume of business: With an average annual growth of 8.2 percent, the company's total volume of business has doubled since 1972, principally because of a nearly threefold increase in toll calling (long distance, WATS and intercity private line services).

Statements of Income and Reinvested Earnings

American Telephone and Telegraph Company and its Subsidiaries

DOLLARS IN MILLIONS (except per share amounts)	Year 1981	Year 1980*	Year 1979*
OPERATING REVENUES			
Local service			
Service and equipment charges	**$21,727.8**	$18,972.4	$16,872.2
Message charges	**2,324.8**	2,184.7	2,173.4
Public telephones	**862.3**	800.4	778.5
Private lines and other services	**638.2**	491.9	384.1
Toll service			
Message charges	**22,232.7**	20,083.3	18,231.1
WATS	**4,487.7**	3,724.3	3,175.7
Private lines and other services	**3,527.2**	2,325.6	1,964.6
Directory advertising and miscellaneous	**3,002.2**	2,775.2	2,288.2
Provision for uncollectibles	**(589.1)**	(494.0)	(459.7)
Total operating revenues	**58,213.8**	50,863.8	45,408.1
OPERATING EXPENSES			
Maintenance	**12,987.7**	10,916.5	9,687.4
Depreciation	**7,900.3**	7,040.4	6,130.4
Network and operator services	**3,580.6**	3,253.3	3,156.9
Marketing and customer services	**5,192.0**	4,319.5	3,554.5
Financial operations	**1,671.1**	1,547.4	1,237.2
Directory	**1,048.9**	917.5	854.7
Research and systems engineering	**507.2**	418.8	362.0
Provision for pensions and other employee benefits (F)	**4,773.5**	4,461.2	4,082.4
Other operating expenses	**1,684.3**	1,430.2	1,171.0
Total operating expenses	**39,345.6**	34,304.8	30,236.5
Net operating revenues	**18,868.2**	16,559.0	15,171.6
OPERATING TAXES			
Federal income taxes (B)	**3,741.6**	3,318.5	3,250.0
State and local income taxes (B)	**460.5**	377.0	356.6
Property taxes	**1,845.6**	1,722.5	1,626.2
Gross receipts, payroll-related and other taxes (T)	**2,584.8**	2,206.1	1,975.6
Total operating taxes	**8,632.5**	7,624.1	7,208.4
Operating income (carried forward)	**$10,235.7**	$ 8,934.9	$ 7,963.2

*See Note (E).

The accompanying notes are an integral part of the financial statements.

DOLLARS IN MILLIONS (except per share amounts)	Year 1981	Year 1980*	Year 1979*
Operating income (brought forward)	**$10,235.7**	$ 8,934.9	$ 7,963.2
OTHER INCOME			
Western Electric Company net income	**711.3**	693.2	635.9
Interest charged construction	**287.5**	271.1	221.9
Miscellaneous income and deductions-net (G)	**16.4**	(72.8)	(82.7)
Total other income	**1,015.2**	891.5	775.1
Income before interest expense	**11,250.9**	9,826.4	8,738.3
INTEREST EXPENSE (T)	**4,362.8**	3,768.1	3,083.6
NET INCOME	**6,888.1**	**6,058.3**	**5,654.7**
Preferred dividend requirements	**145.7**	150.7	156.1
INCOME APPLICABLE TO COMMON SHARES (C)(H)	**$ 6,742.4**	$ 5,907.6	$ 5,498.6
EARNINGS PER COMMON SHARE based on weighted average number of shares outstanding of 788,178,000, 723,516,000 and 686,109,000 in years 1981, 1980 and 1979, respectively (C)(H)	**$ 8.55**	**$ 8.17**	**$ 8.01**
REINVESTED EARNINGS			
At beginning of year (H)	**$24,036.9**	$21,751.3	$19,685.9
Add net income	**6,888.1**	6,058.3	5,654.7
	30,925.0	27,809.6	25,340.6
Deduct dividends declared:			
Convertible preferred shares subject to redemption:			
$4 Convertible preferred shares	**28.0**	32.0	36.2
Preferred shares subject to mandatory redemption:			
$3.64 Preferred shares	**36.4**	36.4	36.4
$3.74 Preferred shares	**37.4**	37.4	37.4
$77.50 Preferred shares	**43.6**	44.6	45.5
Common: 1981, $5.40 per share; 1980, $5.00 per share; and 1979, $5.00 per share	**4,256.6**	3,619.5	3,434.3
Miscellaneous—net	**2.4**	2.8	(.5)
	4,404.4	3,772.7	3,589.3
At end of year	**$26,520.6**	$24,036.9	$21,751.3

Balance Sheets

American Telephone and Telegraph Company and its Subsidiaries

DOLLARS IN MILLIONS (except per share amounts)	1981	at December 31 1980*	1979*
ASSETS			
TELEPHONE PLANT at cost			
In service	**$141,419.2**	$128,879.5	$117,594.0
Under construction	**5,094.2**	4,685.3	4,325.6
Held for future use	**51.0**	68.4	30.9
	146,564.4	133,633.2	121,950.5
Less accumulated depreciation	**26,580.9**	23,605.5	22,092.4
	119,983.5	110,027.7	99,858.1
INVESTMENTS			
At equity (J)			
Western Electric Company	**4,991.2**	4,449.3	4,021.6
Other	**563.7**	494.7	426.7
At cost	**322.0**	315.4	239.9
	5,876.9	5,259.4	4,688.2
CURRENT ASSETS			
Cash	**282.9**	272.3	307.4
Temporary cash investments at cost (approximates market value)	**1,775.5**	1,275.9	1,119.0
	2,058.4	1,548.2	1,426.4
Less drafts outstanding (K)	**795.8**	541.2	563.8
	1,262.6	1,007.0	862.6
Receivables			
Customers and agents less allowance for uncollectibles: 1981, $238.2; 1980, $205.7; and 1979, $170.4	**7,179.9**	6,051.2	5,336.5
Other	**651.3**	732.2	496.2
Material and supplies (principally at average cost)	**1,171.6**	1,017.9	906.5
Prepaid expenses (principally taxes)	**226.6**	205.7	177.9
	10,492.0	9,014.0	7,779.7
DEFERRED CHARGES	**1,397.1**	1,251.8	1,118.1
TOTAL ASSETS	**$137,749.5**	$125,552.9	$113,444.1

*See Note (E).
The accompanying notes are an integral part of the financial statements.

DOLLARS IN MILLIONS (except per share amounts)	1981	at December 31 1980*	1979*
INVESTED CAPITAL, LIABILITIES, AND DEFERRED CREDITS			
COMMON SHARE OWNERS' EQUITY			
Common shares—$16⅔ par value (L)	**$ 13,585.1**	$ 12,580.4	$ 11,689.5
Authorized shares: 1981—900,000,000, 1980—900,000,000, and 1979—750,000,000			
Outstanding shares: 1981—815,108,000, 1980—754,825,000, and 1979—701,367,000			
Proceeds in excess of par value	**14,929.1**	12,703.7	10,942.2
Reinvested earnings—see page 31	**26,520.6**	24,036.9	21,751.3
	55,034.8	49,321.0	44,383.0
CONVERTIBLE PREFERRED SHARES SUBJECT TO REDEMPTION (M)			
$4 cumulative convertible preferred (includes proceeds in excess of stated value)	**335.8**	384.7	432.9
PREFERRED SHARES SUBJECT TO MANDATORY REDEMPTION (M)	**1,562.5**	1,575.0	1,587.5
OWNERSHIP INTEREST OF OTHERS IN CONSOLIDATED SUBSIDIARIES			
Share owners' equity (L)	**415.8**	393.8	1,063.1
Preferred shares subject to mandatory redemption (N)	**553.0**	553.0	500.0
	968.8	946.8	1,563.1
LONG AND INTERMEDIATE TERM DEBT (O)	**43,876.9**	41,255.0	37,167.9
CURRENT LIABILITIES			
Accounts payable			
To unconsolidated subsidiaries	**1,330.2**	1,184.0	1,132.7
Payrolls	**632.6**	550.0	492.8
Others	**1,829.4**	1,786.6	1,875.9
Taxes accrued	**1,574.8**	1,214.9	1,057.8
Advance billing and customers' deposits	**1,476.7**	1,278.8	1,088.3
Dividends payable	**1,145.7**	984.0	935.9
Interest accrued	**1,094.1**	994.6	850.1
	9,083.5	7,992.9	7,433.5
Debt maturing within one year (Q)	**4,019.1**	4,342.1	4,078.2
Taxes relating to California rate order (H)	**1,620.4**	1,422.8	1,304.1
Income taxes deferred for one year	**348.0**	383.6	309.7
	15,071.0	14,141.4	13,125.5
DEFERRED CREDITS			
Accumulated deferred income taxes (H)	**14,037.3**	12,067.3	10,375.0
Unamortized investment tax credits (H)	**6,543.7**	5,574.0	4,612.6
Other	**318.7**	287.7	196.6
	20,899.7	17,929.0	15,184.2
LEASE COMMITMENTS (R)			
TOTAL INVESTED CAPITAL, LIABILITIES, AND DEFERRED CREDITS	**$137,749.5**	$125,552.9	$113,444.1

Statements of Sources of Funds Supporting Construction Activity

American Telephone and Telegraph Company and its Subsidiaries

DOLLARS IN MILLIONS (except per share amounts)	Year 1981	Year 1980*	Year 1979*
FUNDS FROM OPERATIONS			
Net Income	**$ 6,888.1**	$ 6,058.3	$ 5,654.7
Add expenses not requiring funds currently			
Depreciation	**7,900.3**	7,040.4	6,130.4
Deferred income taxes—net	**1,934.4**	1,766.2	1,721.2
Investment tax credits—net	**969.7**	961.4	771.2
Deduct income not providing funds currently			
Interest charged construction	**287.5**	271.1	221.9
Share of equity-basis companies' income in excess of dividends	**197.5**	236.7	184.4
Total funds from operations	**17,207.5**	15,318.5	13,871.2
Less dividends	**4,402.0**	3,769.9	3,589.8
	12,805.5	11,548.6	10,281.4
FUNDS FROM EXTERNAL FINANCING			
Issuance of shares, net of redemptions	**3,168.7**	2,591.7	1,704.2
Issuance of long and intermediate term debt	**3,460.2**	4,728.9	3,409.8
Increase (decrease) in short term borrowings—net	**(513.0)**	83.9	706.4
	6,115.9	7,404.5	5,820.4
Less retirement of long and intermediate term debt	**595.0**	415.0	785.0
	5,520.9	6,989.5	5,035.4
CHANGES IN WORKING CAPITAL† (excluding debt maturing within one year and income taxes deferred for one year)			
Cash and temporary cash investments	**(255.6)**	(144.4)	558.7
Receivables	**(1,047.8)**	(950.7)	(548.8)
Material and supplies	**(153.7)**	(111.4)	(131.5)
Prepaid expenses	**(20.9)**	(27.8)	(2.4)
Accounts payable	**271.6**	19.2	300.8
Taxes accrued	**359.9**	157.1	(295.0)
Advance billing and customers' deposits	**197.9**	190.5	133.2
Dividends payable	**161.7**	48.1	104.9
Interest accrued	**99.5**	144.5	115.1
Taxes relating to California rate order (H)	**197.6**	118.7	298.5
	(189.8)	(556.2)	533.5
OTHER CHANGES†			
Investments	**(420.0)**	(334.5)	(462.0)
Deferred charges	**(145.3)**	(133.7)	(142.1)
Ownership interest of others in consolidated subsidiaries	**22.0**	(616.3)	165.3
Other—net	**216.9**	132.4	203.9
	(326.4)	(952.1)	(234.9)
FUNDS SUPPORTING CONSTRUCTION ACTIVITY	**17,810.2**	17,029.8	15,615.4
Add interest charged construction	**287.5**	271.1	221.9
TOTAL CONSTRUCTION	**$18,097.7**	$17,300.9	$15,837.3

* See Note (E).
†( ) Denotes a change which results in a decrease in funds supporting construction activity.
The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

Dollars in Millions (except per share amounts)

Accounting Policies

(A) The consolidated financial statements of American Telephone and Telegraph Company ("Company") and its telephone subsidiaries reflect the application of the accounting policies described in this note and in Notes (D), (E), (F), (K) and (R). These statements have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission ("FCC") for telephone companies, except for the accounting for investments and revenue refunds described in this note and for a California rate order and related federal tax matter described in Note (H).

Consolidation–The consolidated financial statements include the accounts of the Company, its telephone subsidiaries and AT&T International Inc. The consolidation process eliminates the effects of all significant intercompany transactions except as discussed below under "Purchases from Western Electric." The investment in Western Electric Company, Incorporated ("Western Electric"), an unconsolidated subsidiary, and certain other investments (where it is deemed that the Company's ownership gives it the ability to exercise significant influence over operating and financial policies) are included at equity (cost plus proportionate share of reinvested earnings). All other investments are included at cost. See also Note (J).

Revenue Refunds–The FCC's prescribed accounting provides that refunds of prior years' revenues, less related income tax effects, be charged against current income. However, in conformity with generally accepted accounting principles applicable to rate-regulated utilities, the Company and its telephone subsidiaries in their financial statements treat material revenue refunds applicable to prior years as adjustments of the respective years' income and, within a year, as adjustments of the applicable interim periods' income. See also Note (H).

Purchases From Western Electric–Western Electric has a substantial investment in manufacturing and other facilities which are devoted mainly to its business with the consolidated telephone subsidiaries. Western Electric has supply contracts with the subsidiaries which provide that the prices it charges for the telephone equipment and materials it manufactures or procures for them shall be as low as to its most favored customers for like materials and services under comparable conditions. The consolidated finanical statements reflect items purchased from Western Electric at cost to the telephone subsidiaries, which cost includes the return realized by Western Electric on its investment devoted to the communications business. (See "Telephone Plant" below.)

Telephone Plant–The investment in equipment and materials dedicated to providing communications services is stated at its original cost. The amounts shown do not purport to represent reproduction cost or current value. The original cost of telephone plant obtained from Western Electric includes a return on Western Electric's investment. (See "Purchases from Western Electric" above.) It is impossible to identify the particular purchases from Western Electric over a long period of years which were charged to the plant accounts and now remain therein, but the Company considers that such purchases made by the consolidated companies represent about 50% of the consolidated plant investment. Western Electric advises that its rate of profit before interest charges has varied by years and by classes of sales, but that such rate of profit before interest charges, included in prices for material sold and services furnished to affiliated telephone companies (including items chargeable to other than plant accounts), has been approximately 6% of such sales over the twenty year period ended December 31, 1981 and approximately 7% of such sales over the three year period then ended. Western Electric considers that its rate of profit before interest charges on those items which have been charged to the plant accounts is somewhat higher than its rate on total sales to affiliated companies.

Because the Company and certain of its subsidiaries, including Western Electric, join in the filing of

consolidated federal income tax returns, Western Electric's profits before income taxes included in the cost of those materials and services in the plant accounts of the Company and its telephone subsidiaries are excluded from consolidated taxable income in the year acquired from Western Electric. Instead, such profits are recognized and taxed over the depreciable life of the related plant since, for tax purposes, the Company must exclude Western Electric profits in deriving the depreciable cost of its investment in telephone plant. Consequently, the Company's tax liability is higher than if it were permitted to depreciate the full amount it initially paid to Western Electric. Western Electric provides the Company with the funds necessary to pay the tax liability on these deferred profits in the year in which the Company first acquires the related telephone plant. These payments are treated as reductions of the investment in telephone plant which results in a reduction in depreciation expense over the life of the related plant. However, there is no material effect on Net Income because the decrease in depreciation expense is offset by the aforementioned increase in the income tax provision. See also Note (V).

Material and Supplies–New material and reusable material are carried in inventory at average original cost, except that specific costs are used in the case of large individual items. Nonreusable material is carried at estimated salvage value.

Depreciation–Prior to 1981, the Company's depreciation provision was based on straight-line composite rates, prescribed by the FCC, determined on the basis of the average expected lives of categories of telephone plant acquired in a given year. The Company had expected to determine such straight-line composite rates in 1981 on the basis of equal life groups ("ELG") of certain categories of telephone plant acquired in a given year which would result in a higher depreciation provision than that based on average expected lives. Although the FCC had approved the ELG concept in November 1980, it did not authorize implementation in 1981. The Company's current expectation is that the FCC will authorize the implementation of ELG beginning in 1982. Effective in 1981, the FCC authorized the Company and its telephone subsidiaries to begin implementation of the "remaining life" method of depreciation. The "remaining life" method provides for the full recovery of the investment in telephone plant. Effective January 1, 1981, the FCC also authorized shorter lives for customer terminal equipment. Application of certain of these revised rates and practices will increase depreciation expense more in future years. Such increases should be allowable in determining revenue requirements in rate-making proceedings. See also Notes (C) and (T).

When depreciable plant, other than minor items thereof which are replaced, is retired, the amount at which such plant has been carried in telephone plant in service is charged to accumulated depreciation.

Maintenance and Repairs–The cost of maintenance and repairs of plant, including the cost of replacing minor items not effecting substantial betterments, is, with minor exceptions, charged to operating expenses.

Interest Charged Construction–Regulatory authorities allow the Company and its telephone subsidiaries to accrue interest as a cost of constructing certain plant and as an item of income, i.e., interest charged construction. Such income is not realized in cash currently but will be realized over the service life of the plant as the resulting higher depreciation expense is recovered in the form of increased revenues.

Research–The cost of research and systems engineering performed by Bell Telephone Laboratories, Incorporated ("Bell Laboratories") is included as expense in determining Net Income. The cost of specific development and design work related to products to be manufactured by Western Electric is recovered in the price charged for such products. (See "Purchases from Western Electric" above.)

Income Taxes:

(1) Income tax regulations allow recognition of certain transactions for tax purposes in time periods other than the period during which the transaction will be recognized in the determination of net income for financial reporting purposes. Appropriate income charges and their subsequent reversal, reflected as deferred income taxes–net, prevent the tax effect of these timing differences from distorting net income. The Company recognizes the tax effect of timing differences on the following transactions:

(a) When vacation pay and certain property taxes are deductible for income tax purposes in the year prior to being accounted for in these financial statements, the tax effects of these timing differences are included in Current Liabilities-Income Taxes Deferred for One Year in the accompanying balance sheets. For regulatory accounting and rate-making purposes, these expenses are accounted for when paid.

(b) Depreciation for income tax purposes uses accelerated methods and shortened lives causing such depreciation to be higher during the early years of plant life and lower in later years than the depreciation charges for such plant reflected in these financial statements. The accumulated tax effects of these timing differences are shown in the accompanying balance sheets as Deferred Credits-Accumulated Deferred Income Taxes. See also Note (D).

(2) Investment tax credits result from provisions of the federal tax law which allow for reductions in tax liability based on certain construction expenditures. Corresponding reductions in tax expense are

deferred and, except for the additional one percent credit available under the Tax Reduction Act of 1975 which must be contributed currently to the Bell System Employee Stock Ownership Plan, are amortized as reductions in tax expense over the life of the plant which gave rise to the credits.

Income Taxes

(B) The components of operating income tax expense were as follows:

	1981	1980*	1979*
Federal:			
Current	**$ 785.1**	$ 564.0	$ 782.1
Deferred–net	**1,837.8**	1,640.4	1,588.6
Investment tax credits–net	**1,118.7**	1,114.1	879.3
	3,741.6	3,318.5	3,250.0
State and local:			
Current	**287.9**	222.8	209.4
Deferred–net	**172.6**	154.2	147.2
	460.5	377.0	356.6
Total	**$4,202.1**	$3,695.5	$3,606.6

*See Note (E).

Income taxes on non-operating income included in Miscellaneous Income and Deductions–net were:

	1981	1980*	1979*
Federal:			
Current	**$72.1**	$57.7	$49.0
Deferred–net	**1.5**	2.5	.9
	73.6	60.2	49.9
State and local:			
Current	**11.3**	3.1	5.8
Deferred–net	**–**	.1	–
	11.3	3.2	5.8
Total	**$84.9**	$63.4	$55.7

*See Note (E).

Deferred income tax expense results principally from timing differences between depreciation expense for income tax purposes and depreciation expense reflected in these financial statements.

The effective consolidated federal income tax rate, as determined by dividing Federal income taxes (see above) by the sum of Federal income taxes, Net Income (after excluding the net income applicable to investments in unconsolidated companies accounted for on an equity basis), and the ownership interest of others in the net income of certain consolidated subsidiaries, was 38.0%, 38.1% and 38.9% for the years 1981 through 1979, respectively. The differences of 8.0%, 7.9% and 7.1%, respectively, between the effective rate and the federal income tax statutory rate of 46% are attributable to the following factors:

	1981	1980*	1979*
(1) Certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted currently for income tax purposes, net of applicable depreciation	**2.7%**	3.5%	3.5%
(2) Interest charged construction, which is excluded from taxable income, net of applicable depreciation	**.8**	.9	.7
(3) Depreciation, not deductible for income tax purposes, on that portion of telephone plant costs which represents after-tax profit to Western Electric	**(.8)**	(.8)	(.7)
(4) Amortization of investment tax credits over the life of the plant which gave rise to the credits. Such amortization reduced income tax expense for the years 1981 through 1979 by the amounts shown in Note (T)	**5.2**	4.5	3.7
(5) Other differences	**.1**	(.2)	(.1)
Total	**8.0%**	7.9%	7.1%

*See Note (E).

Revised Depreciation Rates and Practices

(C) Results reflect revised depreciation rates and practices prescribed by the FCC, some of which were effective January 1, 1981, with the remainder being effective July 1, 1981. The resulting change in Depreciation Expense decreased Income Applicable to Common Shares in 1981 by approximately $431.5 ($.55 per share). See also Note (A), "Depreciation."

Accounting for Station Connection Costs

(D) During 1981 the FCC directed that certain costs of installing telephone service on a customer's premises be expensed as of January 1, 1981 instead of capitalized and that the investment in installation costs be amortized. This change increased Maintenance and Other Operating Expenses by $584.1 and $113.1, respectively, and decreased Depreciation Expense by $626.3. This change will continue to increase operating expenses in future years. Such increases should be allowable in determining revenue requirements in rate-making proceedings.

Pending Internal Revenue Service ("IRS") action on the Company's request to make a comparable accounting change, installation costs continue to be capitalized for tax purposes and the tax effects of this timing difference are included in Deferred Credits–Accumulated Deferred Income Taxes.

DOLLARS IN MILLIONS (except per share amounts)

Accounting For Compensated Absences

(E) For the years 1981 through 1979, Net Income has been reduced by \$17.6, \$21.4 and \$19.5 and Earnings per Common Share have been reduced by \$.02, \$.02 and \$.03, respectively, and Reinvested Earnings as of January 1, 1979 have been reduced by \$85.7 to reflect accrual of the liability for vacations and other compensated absences of certain employees. This accrual, which is a change in accounting implemented during 1981 to comply with Financial Accounting Standards Board Statement No. 43, recognizes that this liability for employees expected to be associated with detariffed service offerings must be accrued when earned, rather than when paid which is the accounting method used in the rate-making process.

Provision for Pensions and Death Benefits

(F) Prior to October 1, 1980, the Company, its consolidated subsidiaries, Western Electric and Bell Laboratories sponsored noncontributory plans which covered all employees for service pensions and certain death benefits. Since October 1, 1980 employees of the Company and these subsidiaries have been covered by two national Bell System noncontributory pension and death benefit plans, one for management employees and one for non-management employees. The IRS has approved these two newly designed plans. Contributions to such plans are made to irrevocable trust funds. It has been, and continues to be, the policy of the companies to make contributions which are equal to the current year cost of the plans determined on a going concern basis by actuarial methods specified by the Employee Retirement Income Security Act of 1974 ("ERISA").

To facilitate the year to year comparison of the following data relating to plan costs, the data for individual plans in effect prior to October 1, 1980 have been aggregated:

	1981	1980	1979
Balance of accumulated costs at beginning of year	**\$31,101.2**	\$25,867.0	\$21,829.9
Current year cost	**3,374.7**	3,544.0	3,302.5
Investment income	**NA**	2,911.1	1,704.5
Benefits paid	**NA**	1,220.9	969.9
Balance of accumulated costs at end of year	**NA**	\$31,101.2	\$25,867.0
Current year cost as a percent of salaries and wages	**13.1%**	15.2%	15.9%

(NA = Not Available)

The value of pension fund assets used for actuarial purposes equals the balance of accumulated costs shown above.

Amendments to the plans during 1981 had the effect of increasing 1981 pension cost by approximately \$145.8. The changes in plan design effective October 1, 1980, together with changes in actuarial assumptions and 1980 experience reduced 1981 pension cost by approximately \$960.4. Changes in actuarial assumptions, an amendment to the plans prior to October 1, 1980, and changes in plan design effective October 1, 1980 decreased pension cost for 1980 by approximately \$141.6.

Statement of Financial Accounting Standards No. 36 ("Statement No. 36") requires the following disclosures to be made of the actuarial present value of accumulated plan benefits and the fair value of net assets available for plan benefits ("fair value" essentially is current market value). The following data are based on the latest actuarial valuations; the amounts for 1979 are aggregated for the individual plans prior to the October 1, 1980 changes referred to in the preceding paragraphs:

	at December 31 1980	1979
Actuarial present value of accumulated plan benefits:		
Vested	\$21,163.0	\$18,337.7
Non-vested	3,808.4	2,870.5
Total	\$24,971.4	\$21,208.2
Fair value of net assets available for plan benefits	\$33,523.7	\$25,897.3

The rates of return used in determining the actuarial present value of accumulated plan benefits are the rates used by the Pension Benefit Guaranty Corporation ("PBGC") for determining the value of plan benefits under terminated pension plans and averaged approximately 8.9% and 8.0% annually compounded at December 31, 1980 and 1979, respectively. If the rates used by PBGC had been 1% lower, the actuarial present value of accumulated plan benefits at December 31, 1980 would have been approximately \$28,333.5 instead of \$24,971.4 as shown above.

The Company believes that misleading inferences concerning the plan's funding status may result from a comparison of the actuarial present value of accumulated plan benefits with the fair value of net assets available for plan benefits. This is because plan assets have been accumulated by making contributions equal to current year costs determined on a going concern basis as required by ERISA, while the determination of the actuarial present value of accumulated plan benefits required by Statement No. 36 is essentially a "plan termination" type calculation which uses methods and assumptions which are not the same as those used to determine current year pension costs. The required method for determining the actuarial present value of accumulated plan benefits fails to take into consideration probable future events such as future wage and salary increases and future employee service which have been taken into consideration

by the Company and its subsidiaries in determining costs for the plans. Furthermore, the fair value of net assets available for plan benefits will fluctuate which also may create erroneous impressions with respect to long term progress on funding the pension plans.

Miscellaneous Income and Deductions–Net

(G) Miscellaneous Income for the years 1981 through 1979 includes the net income applicable to investments in unconsolidated companies, other than Western Electric, accounted for on an equity basis of $31.9, $30.6 and $(5.8), respectively. Miscellaneous Deductions for the years 1981 through 1979 include the ownership interest of others in the net income of certain consolidated subsidiaries of $79.8, $164.5 and $152.7, respectively. See also Note (B).

Rate and Related Matters

(H) On February 13, 1980 the California Public Utilities Commission ("CPUC") directed The Pacific Telephone and Telegraph Company ("Pacific"), a subsidiary, to implement a refund order involving revenues collected since August 1974. The revenue refund amounted to approximately $417.6, including interest. The IRS has contended that this refund order renders Pacific ineligible for certain federal tax benefits relating to accelerated depreciation and investment tax credits. In the opinion of counsel, Pacific's eligibility for these federal tax benefits probably would be impaired only insofar as it relates to intrastate plant, which represents approximately 80% of Pacific's total plant. After auditing the 1974 federal income tax return, the IRS assessed a tax deficiency for that year based upon its contention of Pacific's ineligibility for the intrastate portion of these federal tax benefits. The deficiency, including related interest, amounted to $117.4. Pacific paid this amount in February 1980, and in February 1982, it filed a refund claim with the IRS for the $117.4 plus interest from February 1980. If the refund claim is denied, Pacific intends to litigate the issue. Pacific's potential unassessed tax deficiencies, including interest net of related tax benefit, through December 31, 1981 total approximately $1,620.4 and are continuing to grow; payment of these amounts would substantially increase Pacific's need for cash. These financial statements continue to reflect the effects of tax benefit ineligibility on intrastate plant placed in service through February 13, 1980, the date of the CPUC's directive. Recognition of the tax benefit ineligibility reduced Income Applicable to Common Shares for the year 1981 by $106.0 ($.13 per share) and, as previously reported, for the years 1980 and 1979 by $88.7 and $51.8 ($.12 and $.08 per share), respectively, and Reinvested Earnings as of January 1, 1979 by $87.5. Should Pacific's eligibility for these federal tax benefits be reestablished either by litigation or by passage of pending Congressional legislation, the earnings reduction and balance sheet effects related to their loss would be reversed by restatement of the current and prior years' financial statements. It presently is anticipated that plant placed in service subsequent to February 13, 1980 will be eligible for these federal tax benefits since Pacific's intrastate revenues authorized by the CPUC on February 13, 1980 (which are being collected subject to refund) reflect rate-making methods which previously have been considered to be consistent with eligibility. However, such eligibility could be lost should the CPUC later apply retroactive rate-making methods inconsistent with the requirements of the federal tax law. Should this occur, current tax liabilities, including interest, net of related tax benefit, related to California rate orders through December 31, 1981 could be increased by an additional amount of approximately $398.9. On February 13, 1980 the CPUC expressed its intent that eligibility for federal tax benefits be preserved. Certain parties have petitioned the California Supreme Court to review the February 13, 1980 CPUC order. Because the ultimate outcome of these matters has not been resolved, Pacific's books of account used for regulatory purposes and its income tax returns do not reflect the loss of eligibility for federal tax benefits.

As of December 31, 1981 approximately $132.7 ($.17 per share) of intrastate revenues (net of taxes) had been collected subject to refund resulting from revenues collected by Pacific subsequent to the CPUC's February 13, 1980 authorization discussed above and from rate matters in other states which are still subject to refund. It was previously reported that intrastate revenues (net of taxes) of $157.0 ($.22 per share) collected in 1980 were subject to refund. Due to the resolution of various rate matters, it is now the opinion of the Company that the amount of these revenues which are still subject to refund is no longer material.

Interstate Revenues Tax

(I) In August 1979 a county court in Illinois ruled that interstate telephone revenues earned in Illinois are subject to a messages tax. This court decision was appealed and, in March 1981, was reversed by an intermediate appellate court; however, the Illinois Department of Revenue is seeking further review of this issue before the Supreme Court of Illinois. Amounts involved relate to 1967 and subsequent years and will continue to grow. Should it ultimately be determined that these amounts are payable, Income Applicable to Common Shares would be decreased in a future period. If such determination had been made as of December 31, 1981, the decrease in Income Applicable to Common Shares could have been as much as $302.0 ($.38 per share).

Investments at Equity

(J) The FCC's Uniform System of Accounts requires that investments be carried on the books of the companies at cost. However, in conformity with generally accepted accounting principles, certain investments are included at equity in the accompanying balance sheets. See also Note (A), "Consolidation."

DOLLARS IN MILLIONS (except per share amounts)

Western Electric Company, Incorporated and its subsidiaries–Wholly-owned and carried on the Company's books at a cost of $2,318.8 as of December 31, 1981. The following summarized consolidated financial information is for Western Electric:

	1981	1980	1979
Current assets	**$ 5,101.4**	$ 5,103.7	$ 4,483.5
Net plant and equipment	**2,867.7**	2,654.1	2,402.2
Other assets	**369.2**	289.7	240.2
Total assets	**$ 8,338.3**	$ 8,047.5	$ 7,125.9
Current liabilities	**$ 1,881.1**	$ 2,164.9	$ 1,706.4
Long-term debt	**807.1**	816.5	826.6
Other liabilities	**658.9**	616.8	571.3
Total liabilities	**$ 3,347.1**	$ 3,598.2	$ 3,104.3
Sales	**$13,008.0**	$12,032.1	$10,964.1
Operating costs and expenses	**11,549.8**	10,582.5	9,665.0
Net Income	**711.3**	693.2	635.9

Other–At December 31, 1981, includes principally:

Bell Telephone Laboratories, Incorporated–50% owned and carried on the Company's books at a cost of $272.0 which also equals its investment at equity. Its operating revenues are equal to its operating expenses. Western Electric owns the other 50%.

The Southern New England Telephone Company–22.4% owned and carried on the Company's books at a cost of $97.7 plus $6.0 of advances. The Company's investment at equity is $163.2. The market value of the shares owned by the Company based on the closing price as obtained from the Composite Tape was $134.5.

Cincinnati Bell Inc.–30.6% owned and carried on the Company's books at a cost of $48.9 plus $7.0 of advances. The Company's investment at equity is $100.9. The market value of the shares owned by the Company based on the closing price as obtained from the Composite Tape was $76.0.

The following summarized financial information is for the above three principal equity companies combined:

	1981	1980	1979
Telephone plant–net	**$2,452.2**	$2,291.0	$2,106.5
Current assets	**327.0**	268.7	227.4
Noncurrent assets	**852.3**	682.5	532.1
Total assets	**$3,631.5**	$3,242.2	$2,866.0
Preferred shares subject to mandatory redemption	**$ 41.0**	$ 47.5	$ 54.0
Long-term debt	**784.7**	745.5	595.6
Current liabilities	**460.9**	404.6	445.1
Noncurrent liabilities	**693.8**	561.2	482.9
Total liabilities	**$1,980.4**	$1,758.8	$1,577.6
Operating revenues	**$2,990.5**	$2,423.1	$2,102.5
Operating expenses	**2,535.2**	2,051.2	1,759.1
Net Income	**146.3**	114.3	115.6

Cash and Temporary Cash Investments

(K) Cash and temporary cash investments have been reduced by the amount of drafts outstanding with a corresponding reduction in Accounts Payable. It is the practice of the Company and most telephone subsidiaries to make certain payments by draft and to record such drafts as accounts payable until such time as the banks honoring the drafts have presented them for payment. The Company maintains cash and temporary cash investments not only to meet its own obligations but to maintain funds upon which the subsidiary companies may draw on a day-to-day basis to meet their obligations, including coverage for outstanding drafts.

Common Shares

(L) Book value per common share amounted to $67.52, $65.34 and $63.28 at December 31, 1981, 1980 and 1979, respectively.

At December 31, 1981 there were 7,040,240 authorized but unissued common shares reserved for the conversion of the Company's outstanding $4 convertible preferred shares.

Common shares outstanding increased in the periods indicated as follows:

1,024,946, 1,008,811 and 1,432,764 shares issued in the years 1981 through 1979, respectively, upon conversion of the Company's $4 convertible preferred shares. See also Note (M).

18,150,000 shares sold through a public offering in June 1981.

22,775,416, 16,183,915 and 14,923,918 shares sold at 95% of market in the years 1981 through 1979, respectively, under the Share Owner Dividend Reinvestment and Stock Purchase Plan. In addition, 1,565,270, 6,430,372 and 2,362,833 shares were sold at market for optional cash payments in the years 1981 through 1979, respectively, under that Plan.

8,233,895, 8,087,058 and 7,062,500 shares sold at market in the years 1981 through 1979, respectively, to the Bell System Savings Plan for Salaried Employees.

5,908,700, 5,731,700 and 4,300,100 shares sold at market in the years 1981 through 1979, respectively, to the Bell System Savings and Security Plan.

2,621,592, 2,427,063 and 1,736,580 shares issued at market in the years 1981 through 1979, respectively, in connection with the Bell System Employee Stock Ownership Plan through the election of an extra 1% Investment Tax Credit.

Included in the outstanding common shares at December 31, 1980 are 13,589,301 shares that the Company issued in 1981 in connection with the acquisition effective December 22, 1980, of the

remaining ownership interest of others in three consolidated subsidiaries. Included under "Issuance of shares, net of redemptions" for 1980 in the Statements of Sources of Funds Supporting Construction Activity is $662.5 for these shares.

Subsequent to February 8, 1982, the acquisition of the remaining ownership interest of others in Pacific Telephone common and voting preferred shares should become effective. The Company will issue approximately 6,700,000 common shares in connection with the acquisition.

Preferred Shares

(M) Authorized are 100,000,000 preferred shares at $1 par value. Outstanding are:

Convertible Preferred Shares Subject to Redemption

	$50 stated value, $4 cumulative convertible preferred	Proceeds in excess of stated value
December 31		
1979	8,620,292	$1.9
1980	7,661,925	$1.7
1981	6,688,228	$1.4

Each $4 preferred share is convertible into approximately 1.05 common shares of the Company. 973,697, 958,367 and 1,361,125 shares were converted in the years 1981 through 1979, respectively. See Note (L). Each share may be redeemed by the Company at stated value; however, such redemption is not required.

Preferred Shares Subject to Mandatory Redemption

	$50 stated value cumulative preferred		$1,000 stated value cumulative preferred
	$3.64	$3.74	$77.50
December 31			
1979	10,000,000	10,000,000	587,500
1980	10,000,000	10,000,000	575,000
1981	10,000,000	10,000,000	562,500

The $3.64 preferred shares may be redeemed by the Company at a premium of $2.81 per $50 share on or before April 30, 1982 and at a diminishing premium thereafter. On May 1 of each year, commencing in 1984, the Company through a sinking fund must redeem without premium 3% of these shares; an additional 3% may be redeemed each year at the Company's option.

The $3.74 preferred shares may be redeemed by the Company at a premium of $2.89 per $50 share on or before January 31, 1983 and at a diminishing premium thereafter. On February 1 of each year, commencing in 1985, the Company through a sinking fund must redeem without premium 3% of these shares; an additional 3% may be redeemed each year at the Company's option.

The $77.50 preferred shares may be redeemed by the Company at a premium of $55.40 per $1,000 share on or before January 31, 1983 and at a diminishing premium thereafter. On February 1 of each year, the Company through a sinking fund must redeem at stated value 12,500 of these shares through 1992 and 18,750 shares each year thereafter and may redeem an additional equal number each year at the Company's option. Under these sinking fund provisions, the Company redeemed on February 1, 12,500 shares in each of the years 1979 through 1982 which reduced stated capital (as defined in the New York Business Corporation Law) by $12.5 in each year.

The total sinking fund requirement for all series of preferred shares subject to mandatory redemption are $12.5 for 1982 and 1983, $27.5 for 1984, $42.5 for 1985 and 1986. These sinking fund requirements are cumulative; that is, should redemption amounts not be set aside in full because the net assets of the Company are insufficient, or for any other reason, such amounts must be set aside, without interest, before any common share dividends are paid or declared, or any common shares are purchased or redeemed.

All preferred shares rank prior to the common shares both as to dividends and on liquidation but have no general voting rights. However, if dividends on any series of preferred shares are in default in an amount equal to six quarterly dividends, the number of directors of the Company will be increased by two, and the holders of all preferred shares will have the exclusive right, voting separately as a class, to elect such two additional directors so long as such default continues.

Ownership Interest of Others in Consolidated Subsidiaries

(N) Preferred Shares Subject to Mandatory Redemption—Pacific Telephone has authorized 24,000,000 of $25 par value cumulative non-voting preferred shares.

Outstanding shares amounted to 22,120,000, 22,120,000 and 20,000,000 at December 31, 1981, 1980 and 1979, respectively. The dividend rates on these shares ranged from 7.88% to 11.25%. These shares are subject to mandatory pro rata redemptions without premium through annual sinking fund contributions commencing in 1982. The total sinking fund requirements for the years 1982 through 1986 are $17.3, $24.9, $40.5, $42.4 and $46.7, respectively.

Long and Intermediate Term Debt

(O) Interest rates and maturities on long and intermediate term debt of the Company and its consolidated subsidiaries outstanding at December 31, 1981 were as follows (see also Note (T)):

DOLLARS IN MILLIONS (except per share amounts)

Maturities	2⅝% to 6⅞%	7% to 8⅞%	9% to 17%	Total
1983	$ 235.0	$ 250.0	$ –	$ 485.0
1984	355.0	50.0	150.0	555.0
1985	445.0	50.0	200.0	695.0
1986	235.0	–	76.0	311.0
1987-1996	3,607.0	337.5	2,134.0	6,078.5
1997-2006	4,822.0	4,420.6	61.5	9,304.1
2007-2016	1,315.0	10,517.0	2,799.5	14,631.5
2017-2021	–	2,745.0	9,495.5	12,240.5
	$11,014.0	$18,370.1	$14,916.5	$44,300.6
Other				43.0
Unamortized discount–net				(466.7)
Total				$43,876.9

Substantially all of the properties of two of the Company's telephone subsidiaries, comprising about $20,065.3 of the total gross consolidated telephone plant, are subject to lien under mortgage bond indentures with outstanding balances of $2,680.0.

Financing Subsequent to Dec. 31, 1981

(P) Through February 8, 1982 three telephone subsidiaries have contracted to sell or have announced their intention to sell up to $219.5 of long and intermediate term debt. The proceeds of these sales will be applied toward repayment of debt maturing within one year.

Debt Maturing Within One Year

(Q) The Company's telephone subsidiaries follow the practice of financing construction of telephone plant partially through bank loans, commercial paper, commercial notes and other notes, all of which are payable in twelve months or less after issuance, pending long term financing. See also Note (T).

Lease Commitments

(R) The Company and its consolidated subsidiaries lease certain facilities and equipment used in their operations and reflect lease payments as rental expense of the periods to which they relate. See Note (T). At December 31, 1981 the aggregate minimum rental commitments under noncancellable leases were approximately as follows:

Years	Amounts
1982	$ 792.2
1983	671.4
1984	536.3
1985	426.5
1986	309.2
Thereafter	2,731.0
Total	$5,466.6

These leases include some which would be classified as "capital leases" under criteria established by the Financial Accounting Standards Board. However, for regulatory accounting and rate-making purposes, such leases are not capitalized. Had such leases been capitalized, the following amounts would have been included on the balance sheets:

	at December 31 1981	1980	1979
Assets	**$1,781.9**	$1,619.7	$1,573.4
Less: Accumulated amortization	**675.8**	583.7	515.6
Total	**$1,106.1**	$1,036.0	$1,057.8
Lease commitments	**$1,236.9**	$1,103.0	$1,139.8

The effect on Income Applicable to Common Shares, however, would have been insignificant.

Debt maturing within one year is included as debt in the Company's computation of debt ratios and consists of the following at December 31:

	Amounts 1981	1980	1979	Weighted Average Interest Rate 1981	1980	1979
Notes payable:						
Bank loans	**$ 614.1**	$ 903.8	$ 814.5	**13.1%**	18.5%	14.1%
Commercial paper	**1,921.2**	1,930.6	1,999.2	**12.4%**	18.4%	13.2%
Commercial notes	**683.8**	754.9	656.3	**12.5%**	18.7%	13.2%
Other notes	**15.0**	157.8	193.2	**12.3%**	19.0%	12.8%
Long and intermediate term debt maturing within one year	**785.0**	595.0	415.0	–	–	–
Total	**$4,019.1**	$4,342.1	$4,078.2	–	–	–
Average amounts of notes payable outstanding during the year	**$3,206.7**	$3,918.2	$3,040.5	**16.3%***	12.9%*	11.3%*
Maximum amounts of notes payable at any month end during the year	**$3,662.9**	$4,709.1	$3,663.2	–	–	–

*Computed by dividing the average daily face amount of notes payable into the aggregate related interest expense.

Quarterly Financial Information (Unaudited)

(S) All adjustments necessary for a fair statement of income for each period have been included.

Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Earnings Per Common Share*
1979 1st	$10,849.6	$ 1,910.2	$1,356.3	$1.95
2nd	11,251.3	1,989.4	1,443.8	2.06
3rd	11,563.3	2,029.7	1,439.1	2.03
4th	11,743.9	2,033.9	1,415.5	1.97
Total	$45,408.1	$ 7,963.2	$5,654.7	$8.01
1980 1st	$12,105.8	$ 2,098.7	$1,433.5	$1.97
2nd	12,428.0	2,173.2	1,469.9	1.99
3rd	12,991.7	2,270.5	1,550.1	2.08
4th	13,338.3	2,392.5	1,604.8	2.12
Total	$50,863.8	$ 8,934.9	$6,058.3	$8.17
1981 1st	$13,507.0	$ 2,335.0	$1,504.7	$1.92
2nd	14,159.0	2,386.5	1,557.5	1.96
3rd	15,182.3	2,776.2	1,939.9	2.38
4th	15,365.5	2,738.0	1,886.0	2.28
Total	$58,213.8	$10,235.7	$6,888.1	$8.55

*Because of increasing numbers of common shares outstanding each quarter, the sum of quarterly earnings per common share may not equal earnings per common share for the year.

Results for the first, second and third quarters of 1981 have been restated to reflect the use of revised depreciation rates and practices. Such restatements reduced Net Income for these periods by $89.8, $89.3 and $53.3 and reduced Earnings per Common Share by $.12, $.11 and $.06, respectively. See also Note (C).

Results for the first and second quarters of 1981 and for all four quarters of 1980 and 1979 have been restated to reflect the effects of the change in accounting for compensated absences implemented in the third quarter of 1981. See Note (E).

Additional Financial Information

(T)	1981	1980	1979
Depreciation—Percentage of average depreciable telephone plant	**6.05%**	5.86%	5.63%
Amortization of investment tax credits	**$ 523.2**	$ 401.1	$ 316.8
Gross receipts, payroll-related and other taxes:			
Gross receipts	**$1,211.0**	$1,065.8	$ 964.9
Social security	**1,164.9**	940.2	852.5
Capital stock	**146.4**	145.3	106.3
Miscellaneous	**62.5**	54.8	51.9
Total	**$2,584.8**	$2,206.1	$1,975.6
Interest expense:			
On long and intermediate term debt	**$3,608.3**	$3,055.5	$2,610.0
On notes payable	**522.3**	505.1	342.8
Other	**232.2**	207.5	130.8
Total	**$4,362.8**	$3,768.1	$3,083.6
Rental expense*	**$1,398.5**	$1,119.9	$1,004.7
*Includes rental expense for satellite rentals based on usage	**$ 128.4**	$ 116.3	$ 95.4

MCI and Litton Antitrust Litigation

(U) In June 1980, MCI Communications Corporation was awarded $1.8 billion in treble damages in a civil antitrust suit against the Company. In June 1981, in another antitrust suit against the Company and certain Bell System companies, Litton Industries, Inc. was awarded $276.8 million in treble damages. The Company is seeking to have both these awards set aside. In the opinion of the Company's legal counsel, any monetary liability or financial impact to which the Company and the Bell System companies might be subject after final adjudication would not be material in amount.

Department of Justice Antitrust Action

(V) On January 8, 1982, the Company announced it had agreed to a proposal by the Department of Justice which modified the existing 1956 Consent Decree. As a result, both the Department of Justice and the Company have stipulated dismissal of the Department of Justice's 1974 civil antitrust action involving the Company and its subsidiaries. The New Consent Decree is subject to further court proceedings. The terms of the New Consent Decree require that the Company divest those parts of Bell System operating telephone companies that provide local exchange and exchange access service and also require termination of the License Contracts between the Company and the operating telephone companies and the Standard Supply Contract between Western Electric and the operating telephone companies. Interexchange facilities, including those currently owned by the operating telephone companies, would remain a part of the Company, which would continue to own Western Electric and Bell Laboratories. The Company's access to the services of the divested local exchange companies would be on terms and conditions equal to other interexchange carriers. Ownership of customer premises equipment would remain with the Company. The separated local exchange companies would be divested by a spin-off to the Company's share owners or by other disposition.

As a result of such divestiture, the local exchange companies could be required to make immediate payment of approximately $1.0 billion of federal income taxes previously deferred on intercompany profits (see Note (A), "Telephone Plant"). While payment of these deferred taxes should have no direct effect on net income, an immediate payment would increase the local exchange companies' needs for cash. However, the Company believes that, pursuant to tax regulations, a closing agreement is likely to be entered into with the IRS which would result in only a moderate acceleration of the present time period over which these intercompany profits become taxable.

The Company has stated that it will take the necessary measures to maintain the sound financial condition of the operating telephone companies during divestiture including assumption of some of their existing debt, if necessary.

Supplementary Data

Accounting for the Effects of Inflation (Unaudited)
Dollars in Millions (except per share amounts)

Continued high rates of inflation have drawn increased attention to the need to assess both the impact of inflation on business and the results of management's efforts in coping with it. No consensus has been reached either on the preferability of any one reporting method or on the practical usefulness of the resulting data. The Financial Accounting Standards Board ("FASB"), believing that additional experience should be gained and experimentation undertaken with respect to reporting the effects of inflation, issued Statement of Financial Accounting Standards No. 33 ("Statement No. 33") which requires disclosure of supplementary data to reflect the effects of general inflation (constant dollar) and the effects of changes in specific prices (current cost). The data in Tables A and B have been prepared to comply with Statement No. 33; however, the Company believes that it should be used with care because the data neither completely nor accurately portray inflation's effects.

Traditionally, financial statements have been prepared on the basis of historical costs, i.e., the actual number of dollars exchanged at the time each transaction took place. However, it is recognized that general inflation has caused the purchasing power of dollars to decline, the result of which is the presentation of financial statement elements in dollars of varying purchasing power. To eliminate this disparity, such elements may be restated in "constant" dollars, each of which then has equal purchasing power. To reflect the effects of inflation and thus express operating results in dollars of comparable purchasing power, Statement No. 33 requires the Company to show what the FASB characterizes as "income from continuing operations" as if depreciation of plant assets had been based on asset amounts expressed in dollars of constant purchasing power. (This is shown in column (b) of Table A, stated in average 1981 dollars.) This adjustment is derived from the application of the Consumer Price Index for All Urban Consumers ("CPI-U"), a measure of inflation based on changes in the costs to consumers of a wide range of commodities and services.

Technological improvements, changes in supply and demand, and productivity gains cause the specific prices of goods and services purchased by a particular business to fluctuate differently from price changes that would be caused solely by general inflation. To reflect the effects of such specific price changes on operating results, Statement No. 33 requires that the Company also show "income from continuing operations" as if depreciation of plant assets had been based on the "current cost" of these or comparable assets, rather than on historical cost. (This calculation is shown in column (c) of Table A, stated in average 1981 dollars.) Because current cost data are unique to each company, the current cost of telephone plant has been calculated by applying internally-generated indexes to investments in each of the major telephone plant accounts.

In computing "income from continuing operations," only depreciation expense has been adjusted to show the effects of inflation. Because most other operating expense items are current year transactions, they already are recorded in dollars of approximately current purchasing power.

In accordance with requirements of Statement No. 33, no adjustments have been made to reflect any effects of inflation on provisions for federal income taxes. The effective federal income tax rate (operating federal income taxes divided by the sum of operating federal income taxes and "income from continuing operations") for the historical data in column (a) of Table A would be 35.2%. The rate reflecting adjustments for inflation would be 89.0% for column (b) and 63.1% for column (c). While the federal income taxes used in these computations include Investment Tax Credits and tax deferrals relating to accelerated depreciation, the effects of inflation on effective tax rates also would be dramatically increased, even though in lower percentages, if these tax benefits were excluded. These tax benefits were intended by Congress to provide funds for investment in other capital assets in order to increase productivity and employment.

Amounts shown as "net assets at year end" in Table B are the sum of common share owners' equity, convertible preferred shares, and the common share owners' equity portion of the ownership interest of others in consolidated subsidiaries as shown in the historical cost financial statements

which, for general inflation, are adjusted by the difference between telephone plant at historical cost and telephone plant in constant dollars and, for changes in specific prices, are adjusted by the difference between telephone plant at historical cost and telephone plant at current cost.

It is essential that regulatory authorities allow telephone services to be priced at levels that will preserve the Company's ability to attract the continuing additional amounts of capital necessary to meet the public's demand for telephone services. Such price levels need to provide rates of return which, after giving recognition to the effects of inflation, adequately will compensate purchasers of securities for funds provided for telephone plant construction. This inflation-affected compensation would acknowledge higher interest rates for debt securities in anticipation that such debt will be repaid in dollars having less purchasing power; it would acknowledge that returns on equity securities must be comparable with returns available on alternative equity investment opportunities. Because of this comparable return requirement for equity securities, any reflection of "constant dollar" or "current cost" depreciation in the returns on equity of non-regulated companies should result in regulatory recognition of the need for increased returns on equity for the Bell System and thus give recognition to similar inflation effects on its depreciation. Accordingly, the Company has no reason to expect that increases in operating revenues will not keep pace with the effects of inflation on depreciation; the constant dollar and current cost amounts shown for telephone plant investment in the accompanying schedule reflect this premise. Should regulatory authorities not give recognition to the need for such higher equity returns, then the recoverable amount of the Company's plant, when adjusted for the effects of inflation, could be reduced. The amount of such reductions applicable to constant dollar results in 1981 (Table A column (b)) could have been as much as $3,235.8; the cumulative amount of such reductions at December 31, 1981, could have reduced "net assets," as defined herein, by as much as $86,099.0. No reduction applicable to current cost results in 1981 (Table A column (c)) is necessary; current cost depreciation provided for any 1981 reduction that otherwise might have been necessary. However, the cumulative amount of current cost reductions applicable to all years through December 31, 1981, had they been required, could have reduced net assets at December 31, 1981 by as much as $67,630.7.

The reader should note the item identified in Tables A and B as "benefits from decline in purchasing power of net amounts owed." During periods of inflation lenders of money experience a loss due to the fact that amounts owed to them will be repaid in dollars having less purchasing power than the dollars originally lent; it is in anticipation of such loss that interest rates are so high during inflationary times. Conversely, to the extent that lenders are losing purchasing power, borrowers are benefiting. In assessing the impact of inflation on business, the Company believes that the benefits from inflation's effects on money that is borrowed should be viewed as an offset to interest expense. The benefit, however, does not provide funds to the Company.

The disclosure called for by Statement No. 33 is misleading by its incorrect inference that the Company ought not to have paid out more in dividends than its inflation-adjusted income from continuing operations. Statement No. 33 is based on the incorrect premise that depreciation expense, rather than being a means of allocating asset costs to accounting periods, provides funds to be set aside and used for the replacement of those assets being depreciated. Statement No. 33 also assumes that the cost of new assets acquired to replace retired assets will equal the original cost of the retired assets adjusted for either inflation or specific price increases; obviously such is not the case in a high technology industry such as ours. Technological advances hold down price increases for new communications equipment and also increase significantly the productive capacity of both new and existing equipment. As shown in the accompanying Analysis of Construction Program and Cash Utilization (Table C), internally-generated funds, after paying dividends, were sufficient not only to provide all the funds needed for plant replacement, modernization and customer movement, but also to provide $4,830.7, $2,845.6 and $3,350.9 in 1981, 1980 and 1979, respectively, for financing new telephone growth and other corporate investments.

Readers also should note that the increase in the specific prices of telephone plant actually has been less than the general increase in the rate of inflation. This difference primarily is attributable to "benefits of technological improvements in constructing telephone plant." These technological improvements, combined with resulting improvements in productivity, have been responsible for the Company's success in keeping the rate of growth in the prices of its services below the rate of growth in the general level of prices.

Statement No. 33 also requires that the data shown in Table B be presented in a five year summary, restated into the average purchasing power of the dollar during 1981. The calculations for these restatements (except market price per common share) have been made by applying the average CPI-U for 1981 to the data for the years 1977 through 1980. The calculations for market price per common share have been made by applying the average CPI-U for 1981 to the data for the years 1977 through 1981. Since the actual market price for 1981 is stated in year end dollars which have a lower purchasing power than the average 1981 dollar, the effect of the calculation for 1981 is to decrease the year end market price per common share from the actual quoted amount. No adjustments have been made to the historical cost information, which is presented for comparison purposes only.

Table A–Supplementary Financial Data Adjusted for the Effects of Inflation and Changing Prices–December 31, 1981

DOLLARS IN MILLIONS	As Reported in the Historical Cost Financial Statements (a)	Adjusted for General Inflation (Constant Dollars) (b)	Adjusted for Changes in Specific Prices (Current Costs) (c)
Operating revenues	$ 58,213.8	$ 58,213.8	$ 58,213.8
Depreciation	7,900.3	14,325.2	12,602.5
Other operating expenses	31,445.3	31,445.3	31,445.3
Operating federal income taxes	3,741.6	3,741.6	3,741.6
Other operating taxes	4,890.9	4,890.9	4,890.9
Other income	(1,015.2)	(1,015.2)	(1,015.2)
Interest expense	4,362.8	4,362.8	4,362.8
	51,325.7	57,750.6	56,027.9
Income from continuing operations	$ 6,888.1	$ 463.2	$ 2,185.9
Benefits from decline in purchasing power of net amounts owed		$ 3,011.5	$ 3,011.5
Amount by which current cost of telephone plant would have increased if computed by reference to changes in general price levels			$ 15,322.5
Increase in current cost of telephone plant			9,844.3
Difference, primarily due to benefits of technological improvements in constructing telephone plant			$ 5,478.2
Telephone plant, net of accumulated depreciation	$119,983.5	$208,958.8†	$189,873.5†

†Year end 1981 dollars

Table B–Supplementary Five-Year Comparison of Selected Financial Data

DOLLARS IN MILLIONS (except per share amounts)	1981	1980*	1979*	1978	1977
Operating revenues in average 1981 dollars	**$ 58,213.8**	$ 56,117.0	$ 56,895.9	$ 57,173.7	$ 54,702.1
Historical cost information:					
Income from continuing operations	**$ 6,888.1**	$ 6,058.3	$ 5,654.7		
Income from continuing operations per common share[1]	**8.55**	8.17	8.01		
Net assets at year end	**55,786.4**	50,099.5	45,879.0		
Historical cost information adjusted for general inflation (average 1981 dollars):[2]					
Income from continuing operations	**$ 463.2**	$ 1,025.1	$ 2,277.5		
Income from continuing operations per common share[1]	**.40**	1.19	3.03		
Net assets at year end	**140,082.0**	134,601.8	129,804.8		
Historical cost information adjusted for changes in specific prices (average 1981 dollars):[2]					
Income from continuing operations	**$ 2,185.9**	$ 2,167.9	$ 2,807.7		
Income from continuing operations per common share[1]	**2.59**	2.77	3.81		
Difference between the amount by which current cost of telephone plant would have increased if computed by reference to changes in general price levels and increase in current cost of telephone plant	**5,478.2**	6,286.1	12,226.8		
Net assets at year end	**121,613.7**	120,882.7	119,121.5		
Other Information:[2]					
Benefits from decline in purchasing power of net amounts owed in average 1981 dollars	**$ 3,011.5**	$ 7,709.2	$ 8,611.5		
Cash dividends declared per common share:					
At historical cost	**$ 5.40**	$ 5.00	$ 5.00	$ 4.60	$ 4.20
In average 1981 dollars	**5.40**	5.52	6.27	6.41	6.30
Market price per common share at year end:					
At historical cost[3]	**$58.75**	$47.88	$52.13	$60.50	$60.50
In average 1981 dollars	**56.85**	50.39	61.52	81.26	88.59
Average CPI-U	**272.4**	246.8	217.4	195.4	181.5

[1]Income from continuing operations per common share is after preferred dividend requirements.
[2]Certain information for the years prior to 1979 is not disclosed since it is impractical to obtain.
[3]Using Composite Tape closing price.
*See Note (E).

Table C–Analysis of Construction Program and Cash Utilization

Construction program components (approximate):

IN MILLIONS OF HISTORICAL DOLLARS	1981	1980	1979
Plant replacement	**$ 1,090.1**	$ 1,051.2	$ 985.0
Plant modernization	**3,393.4**	3,340.0	3,294.5
Customer movement	**3,373.1**	3,754.3	3,246.3
Growth	**9,953.6**	8,884.3	8,089.6
	17,810.2	17,029.8	15,615.4
Add–Interest charged construction	**287.5**	271.1	221.9
Total construction program	**$18,097.7**	$17,300.9	$15,837.3
Retirements of telephone plant at historical cost	**$ 5,744.8**	$ 6,113.3	$ 5,279.8

*See Note (E).

Internally-generated funds available for investments (See page 34):

IN MILLIONS OF HISTORICAL DOLLARS	1981	1980*	1979*
Funds from operations	**$17,207.5**	$15,318.5	$13,871.2
Decrease (increase) in working capital	**(189.8)**	(556.2)	533.5
Decrease (increase) in deferred charges and other-net	**71.6**	(1.3)	61.8
	17,089.3	14,761.0	14,466.5
Less–Dividends	**4,402.0**	3,769.9	3,589.8
Funds available for investments	**12,687.3**	10,991.1	10,876.7
Less–Amount spent on plant replacement, plant modernization and customer movement	**7,856.6**	8,145.5	7,525.8
Funds available for growth and other investments	**$ 4,830.7**	$ 2,845.6	$ 3,350.9

American Telephone and Telegraph Company

CHAIRMAN OF THE BOARD
Charles L. Brown

PRESIDENT
William M. Ellinghaus

VICE CHAIRMAN OF THE BOARD AND CHIEF FINANCIAL OFFICER
William S. Cashel, Jr.

VICE CHAIRMAN OF THE BOARD
James E. Olson

EXECUTIVE VICE PRESIDENTS
Thomas E. Bolger
Kenneth J. Whalen
Richard R. Hough
Charles E. Hugel
Morris Tanenbaum
Charles Marshall

VICE PRESIDENT AND GENERAL COUNSEL
Howard J. Trienens

VICE PRESIDENTS
Rex R. Reed
Jack A. Baird
James R. Billingsley
John G. Fox
H. Weston Clarke, Jr.
Edward M. Block
William G. Sharwell
John L. Segall
Walter B. Kelley
Robert W. Kleinert
Archie J. McGill
Alfred C. Partoll
Paul M. Villiere
Bruce G. Schwartz
Randall L. Tobias
Sam R. Willcoxon

VICE PRESIDENT AND COMPTROLLER
Robert N. Flint

VICE PRESIDENT AND TREASURER
Virginia A. Dwyer

SECRETARY
Frank A. Hutson, Jr.

Associated Companies

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
William C. Mercer
President

THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY
Alfred W. Van Sinderen
Chairman
Walter H. Monteith, Jr.
President

NEW YORK TELEPHONE COMPANY
Delbert C. Staley
President

NEW JERSEY BELL TELEPHONE COMPANY
Rocco J. Marano
President

THE BELL TELEPHONE COMPANY OF PENNSYLVANIA/THE DIAMOND STATE TELEPHONE COMPANY
William L. Mobraaten
President

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANIES
Robert E. Allen
President

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY
John L. Clendenin
President

SOUTH CENTRAL BELL TELEPHONE COMPANY
Wallace R. Bunn
President

THE OHIO BELL TELEPHONE COMPANY
William E. MacDonald
President

CINCINNATI BELL INC.
Richard T. Dugan
President

MICHIGAN BELL TELEPHONE COMPANY
David K. Easlick
President

INDIANA BELL TELEPHONE COMPANY, INCORPORATED
Philip A. Campbell
President

WISCONSIN TELEPHONE COMPANY
James J. Howard
President

ILLINOIS BELL TELEPHONE COMPANY
William L. Weiss
President

NORTHWESTERN BELL TELEPHONE COMPANY
Jack A. MacAllister
President

SOUTHWESTERN BELL TELEPHONE COMPANY
Zane E. Barnes
President

THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY
Robert K. Timothy
President

PACIFIC NORTHWEST BELL TELEPHONE COMPANY
Andrew V. Smith
President

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY/BELL TELEPHONE COMPANY OF NEVADA
Donald E. Guinn
Chairman
Theodore J. Saenger
President

AMERICAN TELEPHONE AND TELEGRAPH COMPANY LONG LINES DEPARTMENT
Robert W. Kleinert
President

WESTERN ELECTRIC COMPANY, INCORPORATED
Donald E. Procknow
President

BELL TELEPHONE LABORATORIES, INCORPORATED
Ian M. Ross
President

AT&T INTERNATIONAL, INC.
Charles E. Hugel
Chairman
Robert E. Sageman
President

American Telephone and Telegraph Company Board of Directors

Charles L. Brown
Chairman of the Board

Edward W. Carter
Chairman of the Board, Carter Hawley Hale Stores, Inc. (department stores)

William S. Cashel, Jr.
Vice Chairman of the Board and Chief Financial Officer

Catherine B. Cleary
Director and former Chairman of the Board, First Wisconsin Trust Company

William M. Ellinghaus
President

James H. Evans
Chairman, Union Pacific Corporation

Peter E. Haas
Chairman, Levi Strauss & Company (apparel manufacturer)

Edward B. Hanify
Partner, Ropes & Gray (law firm)

William A. Hewitt
Chairman, Deere & Company (farm and industrial tractors and equipment)

Jerome H. Holland
Director of various corporations

Belton K. Johnson
Owner, Chaparrosa Ranch

Juanita M. Kreps
Former U.S. Secretary of Commerce

James E. Olson
Vice Chairman of the Board

Donald S. Perkins
Chairman of the Executive Committee, Jewel Companies, Inc. (diversified retailer)

Henry B. Schacht
Chairman of the Board, Cummins Engine Company, Inc.

Rawleigh Warner, Jr.
Chairman of the Board, Mobil Corporation

Thomas H. Wyman
President and Chief Executive Officer, CBS Inc.

AT&T

American Telephone and Telegraph Company
195 Broadway, New York, NY 10007

BULK RATE
U.S. POSTAGE
PAID
American Telephone
and Telegraph
Company

Return Postage Guaranteed

Litho in U.S.A.